ENFORCEMENT AND ADMINISTRATION OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

HEARINGS

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

JUNE 12 AND 13, 1990

Serial 101-114

Printed for the use of the Committee on Ways and Means

H781-14

U.S. GOVERNMENT PRINTING OFFICE
33-775 WASHINGTON : 1990

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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ENFORCEMENT AND ADMINISTRATION OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

TUESDAY, JUNE 12, 1990

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, D.C.

The subcommittee met, pursuant to call, at 9:30 a.m. in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
TUESDAY, MAY 29, 1990

PRESS RELEASE #30
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES HEARINGS ON THE ENFORCEMENT AND ADMINISTRATION OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will conduct three days of hearings to review the enforcement and administration of the Employee Retirement Income Security Act of 1974 (ERISA). The first two hearings are scheduled for Tuesday, June 12 and Wednesday, June 13, 1990, beginning at 9:30 a.m., in the main Committee hearing room, 1100 Longworth House Office Building. The third hearing is scheduled for Thursday, June 14, 1990, beginning at 9:30 a.m., in room B-318 Rayburn House Office Building.

Over the past year, the Subcommittee has conducted a series of investigations into various cases involving either potential or actual violations of ERISA. In addition, the Subcommittee has initiated reviews of the overall operations of the Internal Revenue Service, the Pension and Welfare Benefits Administration, and the Department of Labor, which are the primary agencies charged with administering and enforcing ERISA.

The first day of hearings will be devoted to receiving testimony from witnesses familiar with the facts surrounding actual pension and welfare benefit cases illustrative of violations of law and the difficulties inherent in enforcing ERISA. On the second day, the Subcommittee will hear from witnesses representing the U.S. General Accounting Office, the Department of Labor Office of Inspector General, the Internal Revenue Service, the Pension and Welfare Benefits Administration, the Department of Justice, and the Pension Benefit Guaranty Corporation. The third day of hearings will be devoted to receiving testimony from public witnesses requesting to be heard concerning issues relating to the administration and enforcement of ERISA.

For the past several decades, the Committee has developed legislation to promote the establishment of employer-sponsored benefit plans. In recent years, the Committee has concentrated on protecting beneficiaries and the Pension Benefit Guaranty Corporation from losses due to insufficient funding of plans. Meeting these objectives has required a variety of legislation involving such issues as prohibited transactions, minimum funding standards, and benefit liabilities in the event of plan termination. In addition, the Committee has attempted to ensure that pension and welfare benefits are broadly available and equitably distributed among covered workers. This has led to legislation in such areas as individual retirement accounts, simplified employee plans, and anti-discrimination rules.

In 1974, the Congress enacted ERISA in order to promote and protect the pension benefits of American workers and their families. Pension and welfare benefit plans involve plan sponsors, administrators, and participants in ongoing contractual relationships which often last for many years. The financial interests and relative bargaining positions of the parties are substantially different. Reflecting the diversity of interests involved in pension and welfare benefits policy, ERISA established a relatively complex system of administration. Under ERISA, the Department of the Treasury, the Department of Labor, and the Pension Benefit Guaranty Corporation are each given certain enforcement and administrative responsibilities.

In announcing these hearings, Chairman Pickle stated: "It has been a long-standing Federal policy to encourage employers and employees to enter into agreements to defer immediate compensation in order to provide for welfare and retirement benefits. This policy promotes sound retirement planning and encourages national savings. Workers rightfully expect that these plans be properly administered and that the laws protecting their benefits be vigorously enforced. Allegations have been made that some of these plans are increasingly the target of fraud and abuse. With $1.7 trillion at risk, and in light of the cases that we uncovered in our investigations, it is time to consider more aggressive enforcement actions. The purpose of these hearings is to determine what improvements should be made in the administration and enforcement of ERISA. Further, the Subcommittee will consider what changes might be appropriate to promote voluntary compliance with ERISA."

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD:

Individuals and organizations interested in presenting oral testimony before the Subcommittee on Thursday, June 14, 1990, must submit their request to be heard no later than the close of business, Tuesday, June 5, 1990, by formal written request to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, room 1102 Longworth House Office Building, Washington, D.C. 20515.

Requests should indicate the specific issues and points the witness wishes to address, in order to facilitate scheduling. It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Those scheduled to appear will be notified as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff at (202) 225-5522.

Witnesses scheduled to present oral testimony are requested to briefly summarize their written statements. The full statement will be included in the printed record.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, all witnesses scheduled to appear before the Oversight Subcommittee are required to submit 100 copies of their prepared statements to the Subcommittee office, room 1105 Longworth House Office Building, at least 48 hours in advance of their scheduled appearance. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written comments for the printed record of the hearing should submit six (6) copies by the close of business, Friday, June 29, 1990, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may provide 100 additional copies for this purpose to the Subcommittee office, room 1105 Longworth House Office Building, by 5:00 p.m., Wednesday, June 13, 1990.

SEE FORMATTING REQUIREMENTS BELOW:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

Chairman **Pickle**. We will ask the subcommittee to please come to order, and will our guests please take their seats.

I have an opening statement. It's a little long, but I want to lay the groundwork for some of the cases and witnesses we will be hearing.

And then Mr. Schulze will make a statement and we will recognize him, followed by members of our staff, to make some preliminary statements and observations. So we will proceed.

Today the subcommittee begins 2 days of hearings on the enforcement and administration of pension and welfare benefit plans established under the Employee Retirement Income Security Act, called ERISA. These plans provide a wide range of benefits and serve as the primary source of private health and pension benefits for over 55 million Americans.

In general, ERISA has been a very definite success. Since its passage, most pension plans have become better funded. Pension assets today exceed $1.7 trillion. This staggering sum is approaching one-half of our Nation's annual gross national product. Pension plans now hold 18 percent of the equity and 27 percent of the corporate bonds in the United States. As a result of ERISA, the worst effects of pension failures have been prevented, and public confidence in the security of the private pension and benefit system has increased.

This success has not, however, been without cost to the taxpayer. The favorable tax treatment provided to pension and health benefit plans amounted to a Federal tax expenditure of over $70 billion in fiscal year 1989. This was more than twice the tax loss due to the home mortgage interest deduction. In addition, through the Pension Benefit Guaranty Corporation (PBGC), the Federal Government has guaranteed pension benefits with a present value of $820 billion. While most of these plans are well funded and unlikely to result in claims against the Federal Government, the administration estimates that the current PBGC deficit for future claims is $1.1 billion. And, this number could increase dramatically, depending on the future events affecting a small number of plans and plan sponsors. Indeed, Richard Darman, the Director of the Office of Management and Budget, has characterized these guarantees as "one of the hidden Pac Men waiting to gobble up our precious Federal resources."

The Ways and Means Committee has been mindful of the problems facing the ERISA benefit system. This committee worked closely with the administration and the labor committees during the passage of the Single Employer Pension Protection Amendments of 1986 and the Pension Protection Act of 1987. These amendments went a long way toward promoting better funding of plans and toward protecting the PBGC and plan participants from the failure of plan sponsors to properly fund their plans. This subcommittee began holding hearings in 1988 to consider how the Department of Labor and the IRS might better enforce ERISA. Following these hearings, the IRS shifted more of its enforcement efforts from plan determinations to plan examinations. In addition, the subcommittee requested that the GAO continue and expand its review of IRS and Labor ERISA enforcement efforts.

This leads us to the issue before us today—how might we better enforce and administer the provisions of ERISA, so as to promote the goals of the pension laws and better protect plan participants and the Federal Government from abusive and fraudulent practices in connection with employee benefits. Recently, this issue has been the subject of considerable discussion. The U.S. Department of Labor Inspector General has reported that ERISA's plans are the target of a variety of criminal schemes and that an increased use of criminal sanctions is needed. Secretary of Labor Elizabeth Dole has also supported a package of legislative proposals and substantial increase in staff for enforcing ERISA. Recently, the IRS has undertaken a reorganization of its enforcement operations.

In order to better understand the problems inherent in ERISA enforcement, and the utility of the various proposed reforms, the subcommittee staff investigated several recent cases involving abusive and fraudulent plan practices. These investigations covered by pension and welfare benefit plans and involved cases in which civil and criminal remedies were pursued.

The six cases that will be presented to us today are illustrative of all these circumstances, and we intend to demonstrate the very real difficulties facing plan participants seeking protection from abusive or fraudulent behavior by plan sponsors. It is my intention to have staff member Tom Arnold, who headed the subcommittee's investigative efforts, present a brief background analysis of each of these cases.

Tomorrow, the subcommittee will receive testimony from the General Accounting Office and the Department of Labor Inspector General, two agencies charged with reviewing overall Federal operations affecting the enforcement of ERISA. Their testimony will focus on the problems that have uncovered in their review of the administration and enforcement of ERISA. The subcommittee will also hear testimony from witnesses representing the Internal Revenue Service, the Department of Labor, the Department of Justice, and the Pension Benefit Guaranty Corporation concerning these agencies' current enforcement activities and plans for improving enforcement of ERISA. Also, the witnesses who requested to be heard have been rescheduled for the hearing tomorrow. We hope we can maintain that schedule. The hearing day scheduled for Thursday, therefore, has been postponed.

In conclusion, I believe it is in everyone's interest to see that our pension and welfare benefit laws are vigorously enforced. There should be no tolerance for these who seek to defraud workers on their hard-earned benefits. While I am aware that there is considerable controversy as to how best this should be accomplished, it is my hope that these hearings will provide the basis on which the Congress might act where necessary.

This Nation's pension plan system is one of the important functions of Government. This subcommittee will continue to have aggressive oversight of those Federal agencies responsible for administering our pension laws and work in tandem with all responsible parties to insure what the pension security workers deserve is in place. In some respects, I feel that the Federal Government's efforts are mere blips on the radar screen. PWBA's 0.59 percent examination rate is insufficient by anyone's standards, almost less than one-half of 1 percent. I should put everyone here on notice that oversight hearings and investigations on ERISA enforcement will continue, and that this is just the beginning.

So, let's begin. We have a full day ahead of us.

Mr. SCHULZE. Thank you, Mr. Chairman. I am pleased to join with you on this hearing.

Over 76 million persons are covered by more than 900,000 pension plans and 4½ million welfare plans. These plans hold $1.8 trillion in assets. ERISA enforcement provisions are supposed to protect these assets so they will be available to pay benefits to the plan participants.

Today we will examine real case histories to see how effectively the current ERISA enforcement rules are operating. Case histories will span the spectrum from larceny to simple mismanagement.

We can learn how to improve ERISA enforcement by studying how pension plan failures take place. Despite the cause of a pension plan's loss, the participants suffer the same loss.

Pension benefits often allow a person to enjoy a comfortable retirement instead of just surviving on Social Security. We should do all we can to assure that the benefits which an employee has earned are not jeopardized by dishonest managers or by risky investments.

This issue will become even more acute early in the next century when the baby boom generation retires. The plans will have to start making significant payouts of benefits. Without strong safeguards, there could be many more cases of shattered dreams.

Mr. Chairman, I look forward to hearing how to improve ERISA's enforcement. Hopefully we can learn from these case histories how to prevent similar cases from happening in the future.

Chairman PICKLE. Thank you, Mr. Schulze.

Now the Chair will ask Mr. Tom Arnold, who has led the review and investigation of some of the ERISA cases, to make sort of a background statement regarding your examination of some of these cases.

Mr. Arnold.

STATEMENT OF THOMAS K. ARNOLD, ASSISTANT COUNSEL, ACCOMPANIED BY JOSEPH G. GRANT, ASSISTANT COUNSEL, AND DANIEL T. MULLANEY, PROFESSIONAL STAFF ASSISTANT, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS

Mr. ARNOLD. Thank you, Mr. Chairman, and good morning.

It's a pleasure to be here today to discuss with you and the members of the subcommittee the results of the subcommittee staff investigation on Federal enforcement of ERISA.

With me this morning is Joseph Grant on my right and Dan Mullaney on my left who assisted in the staff investigation.

The investigation took 6 months. We reviewed Department of Labor files during that time. We were looking forward to finding benefit pension plans, defined contribution plans, welfare. We looked at criminal cases, civil cases and private cases, and after 3 months, we focused on six cases, two criminal, three civil, brought by the Federal Government, and one private.

We interviewed various parties involved in all six of these cases, including most of the Federal officials involved, some of the plan participants, plan trustees, plan attorneys, and others involved with the cases. The 14 witnesses today that follow were selected from those that we interviewed.

I would like now to briefly describe each of the six cases. The first is the Lundberg case. In 1985, Lundberg Industries purchased a potash mine in Carlsbad, N. Mex., from a company called Ideal Basic. This operation, the mining operation in Carlsbad, was virtually worthless.

At that time, Tom Lundberg, who was the president of Lundberg Industries, didn't put any money into the company but signed a promissory note for $3 million. The operation had with it three to five benefit pension plans with assets of $11 million in the plans and More than 800 plan participants.

During the course of the next 18 months, Tom Lundberg and his coconspirators embezzled $9 million from those three pension plans. In June of 1987, he filed bankruptcy. After that, the Pension Benefit Guaranty Corporation came in and took over the plans and started paying the plan benefits to the retirees.

Lundberg and his coconspirators used a number of transactions to embezzle the money from the pension plans. I want to describe just two of those to use as examples.

One of them we call the Joe Wall loan. That was the first embezzlement of money from the plans, and it took place within 30 days of the time that Tom Lundberg gained control of the plan assets.

He loaned $2.6 million to Joe Wall, who in turn purchased mining equipment from Lundberg Industries. However, the mining equipment was encumbered for more than it was worth prior to that sale, so he really sold Joe Wall nothing but paper and took back the $2.6 million that had been loaned to him back into Lundberg Industries.

The Federal investigators—well, the investigators, both State and Federal in this case, tracked that money and discovered that $700,000 of it ended up in Lundberg's personal accounts; $1 million ended up in John Sanders, Tom Lundberg's attorney and fellow trustee of the plan's accounts; $300,000 ended up in a pension and insurance adviser to Lundberg and Sanders; $50,000 went to Joe Wall, and others participated in smaller amounts.

The next transaction was a termination and reversion. Tom Lundberg and John Sanders filed with PBGC for a termination of the plans and took back a reversion of excess assets of $3 million. That money was taken back by the investigators.

The same thing happened in a number of other transactions, the money tracking back into the personal accounts again.

The local citizens in Carlsbad, N. Mex., used a New Mexico law that enabled them to petition for a State grand jury. That is what initially got this case going. There was a State indictment issued by that grand jury which was later dismissed by State courts in August of 1988.

Later, there was a Federal grand jury convened, and Lundberg and Sanders were convicted in Federal court in February 1990, just a few months earlier this year. They were sentenced last month, May 25, to 3 years in prison.

Here today to discuss this case are five witnesses. They form the first panel. Larry Crabtree was retained by Lundberg and Sanders to represent the plans in litigation against Ideal Basic. The Pension Guaranty Corporation as successor in interest to the plans has waived the attorney-client privilege so that Larry Crabtree could testimony both in Federal court at the trial and here today.

Bud Hardin, who is plan participant, he was an employee of Lundberg Industries. He had been employed by the mine owner prior—by Ideal Basic prior to Lundberg Industries and is still employed at the mine. He is also the president of a local union representing workers at the mine.

Denis DeLuche is the chief criminal investigator for the Carlsbad district attorney's office and was initially involved in the State grand jury investigation.

Steve Crowe is a senior special agent with the Department of Labor Inspector General's Office in Dallas, who became involved in the case when the Federal grand jury was convened and the Federal investigation was initiated.

And Bruce Ruud is the deputy area director for the Pension and Welfare Benefits Administration of the Department of Labor, again in Dallas. He supervised three investigators that worked for PWBA who were involved in both the civil and criminal cases.

The next case is the Modern Dairy Farms case. In this case, Herbert Freel purchased the dairy in 1979. At that point, there were 350 employees, 60,000 dairy cows, and the operation had a net worth of $20 million.

Herbert Freel filed for bankruptcy less than 2 years later. And between September 6, 1982 and January 1984, following the bankruptcy, Freel loaned $800,000 to corporations set up in the name of his 26-year-old daughter.

The $800,000 was virtually all of the assets in the pension plan. Those corporations were set up to engage in speculative farming ventures. Those farming ventures failed. The money was lost, and in this case, the defined contribution plan, so PBGC does not insure the plan and the participants are out their money.

Herbert Freel was convicted of mail fraud and embezzlement in 1988 and is now serving a 4-year prison term and has been ordered to pay restitution to the plans, although he has not paid.

Here today to discuss this case are Richard Poole, the assistant U.S. attorney who prosecuted the case in Jacksonville, Fla.; Bill Kish, the PWBA investigator who conducted the criminal investigation which led to the prosecution of Herbert Freel; Edward Weiler, an IRS official from here in Washington who is familiar with the companion excise tax case against Herbert Freel; and Jesse Day, who is a supervisory investigator in the Miami District Office of PWBA. He supervised the companion civil case involving Modern Dairy.

The third case is the Visual Scene case. This involved a manufacturer and distributor of sunglasses. In this case, there were two trustees, Peter Patraka and Myron Orlinsky. They loaned themselves $442,000 between the period of time of 1979 and 1981, during a time when the company was experiencing extreme financial difficulties.

The company later went out of business in 1984. As of February 1987, when PWBA performed a calculation, there were only about—there was only about $5,000 left in the plan at that point.

They also calculated that the value of the loans, including accrued interest, was $700,000, but that was worthless paper at that point.

At this point now, enough has been recovered from the trustees Patraka and Orlinsky to cover the participants other than themselves. That amount is about $250,000, and that money has been paid to the participants last year.

Jesse Day is on the second panel. He was here to discuss both the civil Modern Dairy case and this civil case, the Visual Scene's case. This was a defined contribution plan and would not have been covered by PBGC had not the assets been recovered.

The fourth case is the Plumbers & Steamfitters Local Union 131 case. This is a defined benefit pension plan. In March and May, 1984, two below market rate investments were made by the plan administrator. Those became the subject of the PWBA civil investigation.

The first transaction was a $1.5 million 3-year certificate of deposit that was invested at a bank in exchange for the bank issuing a below market rate construction loan for the development of a project which would require the use of union labor.

The next transaction was a direct loan of $1.2 million to purchase an old building that was intended to be renovated.

Later, the plan administrator gave up the plan's first mortgage position and extended the loan to allow the developers to obtain $4.5 million in renovation financing.

In 1989, PWBA recovered $107,000 from the plan and required that the plan hire a new plan administrator or fiduciary to make investments for the next 10 years.

James Benages, area director of the Boston area office of PWBA, is on panel 2 to discuss this case.

The fifth case is the Massachusetts Laborer's Legal Service Fund. This is a welfare benefit case—welfare benefit plan, a civil case.

This plan was formed in 1974 by a number of construction contractor associations and the Massachusetts Laborers District Council of the Laborers International Union. There are some 14,000 participants who received prepaid legal services from this plan.

The primary vehicle for delivery of those services is a main office in Newton, Mass., which is a suburb of Boston. At that office, there are four staff attorneys and the plan administrator to deliver the legal services.

The plan also maintains satellite operations at four other sites. The plan collects about $1 million a year through employer contributions and lets a little less than that to operate the plan.

PWBA found that the plan kept inadequate records and may have cost more per case than some other plans. A consent judgment was entered into in August 1989, which ordered the plan to keep better records and to obtain a consultant to review the operation of the plan.

The consultant's report was completed in February 1990, and the bottom line is the consultant determined that there were no problems at this point in time with the operation of the plan.

The third panel is made up of witnesses that are here today to discuss this case. Paul McDonough is the senior investigator from the Boston area office of PWBA. Mike Felsen is a trial attorney with the Department of Labor Solicitor's Office in the Boston region. And Dick Coleman, he is the plan's outside counsel and was involved in the case throughout the PWBA investigation and the settlement negotiations.

The last case is United Technologies Corp., Carrier employees plans. These are defined benefit plans. United Technologies purchased Carrier and a subsidiary of Carrier, Spectrol, in the late 1970's.

According to one of the plan participants, Earl Engelhardt, who is here to testify today, the benefits statements received by plan participants changed after United Technologies took over the plans. Prior to United Technologies taking over the plans, the Spectrol plans, plan participants were able to collect lump-sum payments of their benefits upon retirement.

Also, according to Mr. Engelhardt, prior to the UTC takeover, plan participants were allowed to calculate plan benefits for the period of time they had served as hourly employees, as well as salaried employees, even though that was covered—those periods of service were technically covered by two different plans, the carriers allowed them to calculate their period of service for both plans and pay at one higher benefit.

And according to Mr. Engelhardt, United Technologies is not allowing them to do that.

Mr. Engelhardt last attempted to get help from the Department of Labor and the Internal Revenue Service. He has been unsuccessful at doing that, and is now planning to bring a private lawsuit. He is trying to raise enough money by putting together a class to bring a class action suit, and he is here to testify with his attorney today, Roger Thomas.

In conclusion, based on our review, it appears that the Federal ERISA enforcement effort is inadequate. Excepting the efforts of the individuals who are testifying today, I would say that there are too few officials and they are spread too thinly, and there is too many opportunities for things to fall between the cracks and for duplication of efforts.

The agencies seem to focus on their individual missions, narrow missions, and there is a lack of focus on the big picture.

Mr. Chairman, if you or any of the other members have any questions, we would be happy to try to answer them.

[The prepared statement follows:]

STATEMENT OF THOMAS K. ARNOLD
ASSISTANT COUNSEL
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS

Good Morning, Mr. Chairman. It is a pleasure to be here today to discuss with you and the Members of the Subcommittee the results of the Subcommittee staff investigation on Federal enforcement of the Employee Retirement Income Security Act of 1974 (ERISA). With me this morning are Joseph Grant and Dan Mullaney who assisted in the staff investigation.

The Oversight staff has spent the last six months reviewing Department of Labor files and interviewing interested parties in a number of ERISA cases. We wanted to learn exactly what various agency officials have done to resolve ERISA cases. Initially, we looked at a variety of cases involving both defined-benefit and defined-contribution pension plans as well as cases involving welfare benefit plans. We also looked at cases which resulted in criminal convictions, cases which resulted in civil judgments, and cases which involved private actions. Finally, we focused on cases involving each of the Federal agencies charged with enforcing ERISA.

After the first three months, our investigation focused on six cases which illustrate Federal enforcement of ERISA. At that point we attempted, with mixed success, to interview all Federal officials and at least some plan participants, plan trustees, plan administrators and plan attorneys involved with these cases. The fourteen witnesses who are scheduled to testify before the Subcommittee today were selected from the individuals we interviewed. They have been asked to include in their statements an explanation of their involvement in these cases and to be prepared to answer questions from the Members regarding their cases.

Now I would like to briefly describe each of the cases we reviewed:

1) Lundberg Industries Ltd. - defined-benefit pension plans

In December, 1985, Lundberg Industries Ltd. purchased a potash mine in Carlsbad, New Mexico, from Ideal Basic Industries, Inc. (Ideal) by executing a promissory note for $3 million. Lundberg Industries received $11 million from Ideal for the three defined-benefit pension plans covering 400 potash miners and 400 retirees. During the next 18 months, Tom Lundberg and a number of co-conspirators embezzled over $9 million from the pension plans. In June, 1987, Lundberg Industries Ltd. filed for bankruptcy. The Pension Benefit Guaranty Corporation took over the plans and is now paying benefits to the retirees.

Tom Lundberg embezzled the cash from the pension plans through a series of transactions. The first involved a sham loan from the plan to one of the co-conspirators for the supposed purchase of mining equipment from Lundberg Industries. The pension plans "loaned" $2.57 million to the co-conspirator to finance that purchase. Of that, $700,000 ended up in Tom Lundberg's personal accounts. One million dollars ended up in his attorney's account; $300,000 went to Mr. Lundberg's pension and insurance advisor; and, $50,000 went to the co-conspirator. In another transaction, Tom Lundberg "terminated" the pension plans and paid over $3 million to Lundberg Industries. These funds were later traced by State and Federal investigators into Mr. Lundberg's and other co-conspirator's personal accounts.

Initially, the Federal Government did very little to investigate this case. However, the citizens of Carlsbad used a New Mexico law to petition the State to convene a grand jury. In August, 1988, the New Mexico State courts dismissed the State grand jury's indictment because of Federal preemption in pension fraud cases. The U.S. Attorney's Office eventually decided to prosecute the case and, in February, 1990, Tom Lundberg and some of his co-conspirators were convicted of embezzlement in Federal court. On May 25, 1990, Tom Lundberg and John Sanders, both trustees in the plan, were sentenced to three years in prison and the remaining co-conspirators were sentenced to probation.

All five witnesses on the first panel today were involved in the Lundberg case. Bud Hardin is a plan participant and former employee of Lundberg Industries Ltd. He is still employed at the potash mine which was once operated by Lundberg Industries. Larry Crabtree was hired by Tom Lundberg, and John Sanders, Mr. Lundberg's attorney, to represent the pension plans in litigation against Ideal. Mr. Crabtree later withdrew his representation after becoming suspicious of Lundberg's and Sanders' activities.

Denis DeLuche is the local Carlsbad District Attorney's chief criminal investigator. He was the first criminal investigator to aggressively investigate the case. Steve Crowe is a special agent with the Department of Labor, Dallas Regional Inspector General's office. He became actively involved in the case after the State charges were dismissed. Finally, Bruce Ruud is the Area Director of the Pension and Welfare Benefit Administration, PWBA, Dallas Area office. Bruce supervised the three PWBA investigators involved in both the criminal case and a companion civil case.

2) Modern Dairy Farms - a defined-contribution pension plan

In 1979, Herbert Freel purchased Modern Dairy Farms, Inc. in Okeechobee, Florida. At the time, the dairy was prosperous with 350 employees, 60 thousand dairy cows, and an estimated net worth of $20 million. Within two years of purchasing the farm, Mr. Freel filed for bankruptcy.

During the 16 month period between September, 1982 and January, 1984, Mr. Freel "loaned" $800,000, all of the plan's assets, to two corporations set up in the name of his 26-year-old daughter. Using the plan's money, these corporations started a highly speculative farming venture that Mr. Freel hoped would rescue him from his financial difficulties. Those ventures failed and nearly all of the money in the plan was lost. On January 8, 1988, Freel was convicted of mail fraud and embezzlement. He is now serving a four year sentence in Federal prison and was ordered to pay restitution. This plan was a defined-contribution plan and thus was not insured by the Pension Benefit Guaranty Corporation.

Four of the witnesses scheduled on the second panel today were involved with this case. Richard Poole was the Assistant U.S. Attorney who tried the case. Bill Kish was the Pension Welfare Benefit Administration, Miami District Office investigator who investigated the case; Jesse Day supervised both Bill Kish and the two civil case investigators; and, Edward J. Weiler, from the Internal Revenue Service is familiar with the companion excise tax case against Herbert Freel.

3) Visual Scene, Inc. - a defined-contribution pension plan

The two trustees of this plan, Peter Patraka and Myron Orlinsky, borrowed $442,000 from the Visual Scene Inc. plan between 1979 and 1981 when the company started experiencing extreme financial hardships. The company eventually went out of business in 1984. As of February, 1987, there was less than $5,000 in the plan accounts. In March, 1989, the Department of Labor obtained a judgment against Mr. Patraka and Mr. Orlinsky who have now repaid enough of the loans to cover benefits owed to all participants other than themselves. This was a defined-contribution plan.

Jesse Day, from the PWBA Miami office, who was actively involved in attempting to resolve this case is here today.

4) Plumbers and Steamfitters Local Union 131 - a defined-benefit pension plan

In March and May, 1984, the Plumbers and Steamfitters Union in Manchester, New Hampshire, made two below-market-rate investments to finance construction projects which would generate work for the union members. The first investment was a $1.5 million, three-year, certificate of deposit at the New Hampshire Savings Bank. In exchange for this below-market-rate CD, the Bank made a below-market-rate construction loan to a developer who agreed to use union labor on a specific building project.

The second investment of the plan's money involved a direct loan of $1.2 million to developers for purchase of a building which the developers intended to renovate. In order for the developers to later get $4.5 million in renovation financing from a bank to complete the project, the plan extended the loan repayment period and gave up its first mortgage position on the property. In 1989, the Department of Labor obtained a consent judgment requiring the trustees to return $107,000 in lost interest to the plan and to hire an independent fiduciary to make all investments for the next ten years.

This case was investigated by the PWBA Boston Area Office. James Benages, the Boston Area Director, is here today, on the second panel, to discuss this case.

5) Massachusetts Laborers Legal Services Fund - a welfare benefit plan

The Massachusetts Laborers Legal Services Fund was established in 1974 by several construction employer associations and the Massachusetts Laborers District Council of the Laborers International Union. Through one main office in Newton, Massachusetts and several satellite operations throughout New England, the plan delivers legal services to a population of 14,000 participants. Most services are delivered by four attorneys and the plan administrator at the main office. The plan collects a little over $1 million a year from the employers and spends a little less than that for operating expenses. Several of the plan attorneys and other plan employees were, at the time of the investigation, related to the plan trustees.

The Department of Labor investigation, which began in March, 1987, found that the plan did not keep complete or accurate time records and that, as compared to one other legal services plan, incurred higher costs per case. In August, 1989, Labor obtained a consent judgment ordering the plan to keep better records and to contract for a consultant to evaluate the plan's services. The consultant completed his report in February, 1990, finding that the plan is now functioning well and that the plan's costs are not out of line.

The witnesses here today to discuss this case are on the third panel. Paul McDonough is the Boston PWBA investigator who had primary responsibility for this case. Mike Felsen is the Trial Attorney with the Boston, Department of Labor, Regional Solicitor's office, who negotiated the consent judgment in the case. Dick Coleman represented the plan throughout the PWBA investigation.

6) United Technologies Corporation, Carrier Employees - a defined-benefit plan.

Spectrol Control Systems was a subsidiary of Carrier Corporation which was purchased by United Technologies Corporation (UTC) in the late 1970s. The pension plan covering the Spectrol employees was transferred to UTC at that time. Soon thereafter, according to Mr. Engelhardt, several of the plan participants started receiving statements from UTC regarding their pension benefits which differed substantially from what they had been told by Carrier over the years. For example, UTC said that the Spectrol employees could not withdraw their plan benefits in a lump sum and again, according to Mr. Engelhardt, that those participants who worked as both hourly and salaried employees would receive separate benefits from each of two plans rather than one larger benefit from the salaried plan. Carrier had taken the opposite position on both of these issues.

Earl Engelhardt has tried unsuccessfully for several years to persuade the IRS or the Department of Labor to investigate these and other allegedly retroactive changes to plan benefits. Currently, Mr. Engelhardt is attempting to organize a group of participants to bring a private class-action lawsuit in Federal court.

Mr. Engelhardt is here to testify about his attempts to obtain assistance from the plan officials and the Federal Government, as well as, his attempts to organize the class-action suit. Mr. Englehardt is accompanied by his attorney, Roger Thomas.

In conclusion, based on our review, it appears that the Federal ERISA enforcement effort is inadequate. While the individuals here today have each done their personal best to timely resolve these cases, there are too few Federal officials involved in the effort and those few officials are spread too thinly among all of the agencies who have jurisdiction over various aspects of ERISA enforcement. There are numerous opportunities for information to fall between the cracks and, at the same time, for duplication of efforts. Each agency tends to focus on its own narrow mission and there appears to be a lack of focus on the big picture.

Mr. Chairman, if you or any of the other Members have any questions, we would be happy to try to answer them.

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Chairman Pickle. Well, I thank you, Mr. Arnold, and I appreciate your review of these six specific cases.

Does either Mr. Grant or Mr. Mullaney want to make any statement at this point?

Any members of the committee have any questions of staff?

Mr. Schulze. Mr. Chairman, I have a couple of questions.

Mr. Arnold, how did the majority staff select the cases which were investigated?

Mr. Arnold. We reviewed Department of Labor public records of about 200 cases, went through and read descriptions of those cases, looked for cases that would involve all five Federal agencies—PBGC, IRS, Labor, IG, and Department of Justice—at least some cases, cases that represented defined benefit plans, and looked to see if there was a difference in the way they were treated.

And we also wanted to make sure we included at least one welfare benefit plan.

Mr. Schulze. Would you describe these cases as typical or average or extreme? In the spectrum, how would you rate the cases which were selected?

Mr. Arnold. I would say that they are not extreme. But I also don't know that I would go so far as to say they are typical. I think they are illustrative of the mechanics or anatomy of Federal enforcement.

Mr. Schulze. Were there any cases which you wanted to investigate but were unable to?

Mr. Arnold. No. There were one or two very complex and currently open cases that we were tempted to investigate but would have taken substantial amounts of time, and we would have had to be very careful with how to treat those cases here today because they are still pending litigation.

Mr. Schulze. Were other Federal agencies or individuals cooperative, or were there those who were not cooperative?

Mr. Arnold. Actually, I would say across the board, the Federal agencies were very cooperative with us in making files available and making individuals available.

Mr. Schulze. In your investigation, did you come up with any new information which had not previously been discovered by Federal agents?

Mr. Arnold. No.

Mr. Schulze. Thank you, Mr. Chairman.

Chairman Pickle. Any other members have questions?

Thank you, Mr. Schulze.

Thank you, Mr. Arnold and members of the staff.

The first panel will consist of Larry Crabtree, Bud Hardin, Denis DeLuche, Stevens Crowe, and Bruce Ruud.

Will these five gentlemen take your place at the witness table, please.

Let me identify these people, if you would hold up your hand.

Mr. Larry Crabtree is a partner of King & Ballow, Nashville, Tenn.; and he was former accountant to the Lundberg Ltd. pension plan.

Then Mr. Warren Bud Hardin, a plan participate of Lundberg Industries, Ltd. pension plan from Carlsbad, N. Mex.

Mr. Denis DeLuche, chief criminal investigator, fifth judicial district attorney's office out of Carlsbad, N. Mex.; Mr. DeLuche, in the center there.

Mr. Stevens Crowe, senior special agent, Office of the Inspector General, the Dallas regional office, Mr. Crowe; and Mr. Bruce Ruud, area director of the Pension and Welfare Benefit Administration, Dallas office.

We will ask each one of you witnesses to make your statement. We also ask that you keep it under 5 minutes so that we can move on to each witness. We have four or five panels today, so we want to get our statements in as quick as we can, but we want to limit no one. But we would appreciate your summarization.

So first, Mr. Larry Crabtree, will you proceed?

STATEMENT OF LARRY D. CRABTREE, PARTNER, KING & BALLOW, NASHVILLE, TENN., FORMER COUNSEL TO LUNDBERG INDUSTRIES LTD. PENSION PLANS

Mr. **Crabtree**. Thank you, Mr. Chairman and respective members of the subcommittee.

I am Larry Crabtree, a partner in the law firm of King & Ballow, and I am in charge of our tax section. Our firm represents, among other clients, over 300 newspapers in 42 States, including the Houston Chronicle, the Chicago Tribune, and the New York Daily News, each of which I have worked for. Due to time constraints, I will move directly to my colloquy and touch briefly on the points detailed in there.

In early April 1986, I was contacted by David Boatright, an actuary with respect to specific legal research, involving a plan spinoff issue. Mr. Boatright provided me with the details of Mr. Lundberg's purchase of the division from Ideal Basic Industries, and his assumption of the three defined benefit pension plans. The initial views involved irrevocable commitments issued by Aetna. We began to investigate that.

Mr. Lundberg thought he had assumed the plans in a spinoff from a larger plan set up by Ideal Basic, and would assume surplus assets that would have been available in the event of plant termination. That soon proved to be wrong, after Mr. Lundberg and Mr. Sanders were appointed as successor trustees to the prior trustee, First Interstate Bank of Denver.

First Interstate proceeded to transfer the assets and notified the Aetna to discontinue its contract. The Aetna retained assets in excess of $9 million to satisfy benefit commitments valued slightly in excess of $7 million. The plans went from having a purported surplus of more than $1 million to a deficit of more than $1 million.

I advised the commitments should have been segregated out. Ideal's legal counsel called me and advised that the three plans had not been spun off, but that Lundberg assumed them in total with their deficits. Boatright, Sanders and Donaldson met with my firm regarding a potential action against Mercer-Meidinger, on account of representations they relied upon negotiating with Ideal.

They advised me that discrepancies had been found in benefit obligations for which Lundberg was responsible. We had raised the issue of Aetna's possibly releasing a portion of the $2 million. We also assisted in freezing benefit accruals to avoid an even larger deficit.

Mr. Boatright suggested spinning off certain benefit obligations from the plans to a spinoff plan. While our firm agreed that this action would consolidate administration to a single plan, it could not result in any reversion to Lundberg Industries.

Aetna offered a nonparticipation conversion under their contract. When pressed, Aetna could not positively state a specific monetary figure which would be released. Mr. Sanders became incensed, and made the decision to delay filing a lawsuit against Mercer-Meidinger to sue the Aetna, premised largely upon the theory that Aetna was a fiduciary on account of its control over plan assets.

While we believe the better cause of action existed against Mercer-Meidinger, a complaint was filed against Aetna in October 1986. A lawsuit was subsequently filed against Lundberg by former employees of Ideal for health and retirement benefits.

During December 1986, Mr. Boatright called me regarding use of assets of the plan for a loan to acquire property by a third party from Mr. Lundberg. I advised Boatright, a separate Dallas attorney, and Sam Longo that the transaction would be a prohibited transaction. I subsequently learned they proceeded with the transaction with 127, Inc., about 1 week after I had advised against it.

An additional issue brought to my attention was the sale of Lundberg's stock to one of the plans. I advised Mr. Boatright such stock acquisition should probably be reported as a prohibited transaction on the IRS form 5500. The client had not requested my opinion on that issue.

It later came to my attention that the stock had been resold to Lundberg for precisely the same amount as the sale to the plan. I was not consulted on the sale to the plan, nor on the resale to the employer.

In March 1987, I attended the pretrial conference with Mr. W.T. Martin, the attorney who represented the former Ideal employees. We used that opportunity to first meet Mr. Lundberg personally.

Mr. Dick Horton, Lundberg's personnel director, made a casual comment regarding benefit distributions, which had already been made to participants. I expressed shock at the fact that distribution had occurred since I had not yet filed with PBGC.

I had been concerned as to the lack of contact with Mr. Lundberg. I questioned Mr. Lundberg regarding the fact that the plan distributions had occurred, and he stated that Sanders and Boatright assured him distributions occurred under appropriate circumstances.

On returning to Nashville, I confronted Sanders and Boatright. I was informed that Sanders made the decision to have Boatright file with the PBGC. I expressed outrage at having not been informed as to the transactions which could have an effect on the litigation and negotiations. No one volunteered at that time a reversion had also already occurred.

We proceeded on the issue of the insurance company possibly being a fiduciary under ERISA, even though DOL regulations stated insurance companies would not be fiduciaries under normal circumstances involving group annuity contracts, a position that we believe does not fit legislative history. My review of the Aetna contract convinced me Aetna had such control.

We proceeded also to complete our research for the action against Mercer-Meidinger. To prepare the complaint, we traveled to Dallas to interview Lundberg, Sanders, and Donaldson regarding the events leading to Lundberg's acquisition from Ideal. Lundberg was interrupted by a call from Joe Wall. Mr. Lundberg asked that I speak with him regarding the transaction which had occurred between him and the plans.

I informed Mr. Wall I could not represent him. While we had not been employed by Lundberg at the time the transaction occurred, I decided I would have to confer with my firm regarding how the transaction might affect the litigation in which we were involved and how it might create problems.

We also scheduled a meeting with Don Templeton to discuss his law firm's possible settlement of the separate Ideal lawsuit, because it could affect the lawsuit brought by former employees of Ideal against Lundberg. Mr. Templeton inquired as to our knowledge of the transaction in which several million dollars had been transferred to Lundberg Industries from the pension plans. We advised him such information had not previously been known to us.

In the interview with Mr. Sanders the following morning, we raised the issue of the plan reversion having occurred without our knowledge and under circumstances which violated the joint implementation guidelines. I reminded Mr. Sanders that he had taken from me the responsibility for the PBGC filings.

I advised him that I saw no solution to the problem other than the immediate purchase by Lundberg Industries of the annuity contracts necessary to guarantee the benefits of participants who had not received cash distributions. We also advised Mr. Sanders that the reversion severely compromised the ongoing litigation with the Aetna and the proposed litigation against Mercer-Meidinger.

One of the most serious considerations I posed to Mr. Sanders was the violation of the joint implementation guidelines. We were not aware of the severe financial difficulties under which Lundberg Industries was operating, and the fact that all those reversion assets had already been disbursed from the corporation to various parties.

Mr. Sanders stated that we should make sure that Mr. Boatright was adequately protected with respect to his involvement in the transactions. I advised Mr. Sanders that we did not represent Mr. Boatright, and that our concerns related to the integrity of the plans and how the transactions might adversely affect the ongoing and pending litigation.

After returning from the prelitigation interviews, our law firm held a meeting to discuss the problems and to determine how we should proceed. We began to review the applicable disciplinary rules and ethical considerations. We advised Lundberg and Sanders that it was absolutely necessary either to return the assets or to purchase annuity contracts.

During this process, we received notice that Lundberg Industries had filed for bankruptcy. Because Lundberg Industries' Dallas offices moved without our knowledge, we were not certain certain letters that we had sent had been received by Mr. Lundberg. We were unable to reach Lundberg or Sanders by phone.

In response to our filing a request for an opinion with the disciplinary board for the State of Tennessee, we received a reply that stated that we must withdraw from representation, and we proceeded to do so. In the latter part of 1987, I was contacted by the bankruptcy trustee, David Elmquist, who moved for and obtained my appointment as special counsel to the bankrupt trustee.

In late 1987, they took my deposition in the civil litigation. In addition, I was subpoenaed for and did testify in the criminal trial of Lundberg and Sanders earlier this year.

In my opinion, the problems experienced by Lundberg Industries arose with respect to the fact that Mr. Sanders failed to obtain a warranty as to the existence of the purported surplus assets. However, that failure was in no way involved with the prohibited transaction which occurred in January 1986 with Mr. Joe Wall.

I do believe it had a large impact on his decision to delay our filing a lawsuit against Mercer-Meidinger. I have no explanation for why the attorney who consulted with me regarding the proposed transaction involving the 127, Inc., proceeded to document the transaction as he did.

With respect to the sale of Lundberg Industry stocks to the plans, I believe Mr. Boatright honestly believed it was permissible. Had I been permitted to remain responsible for the filings with PBGC, I think I would have been able to prevent the impermissible reversion from occurring.

I wish that I could tell this subcommittee that I had the absolute solution to the problems under ERISA. However, I do not. Due to time constraints, while I could suggest greater input from the private sector practitioners on potentially abusive areas, and I can suggest numerous other changes which would better protect qualified plans, time prohibits that.

In conclusion, I encourage this subcommittee in its endeavors to arrive at solutions to the problems in ERISA administration and enforcement.

I thank you for the opportunity to speak before this respected body.

[The prepared statement follows:]

STATEMENT OF LARRY D. CRABTREE
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS

June 12, 1990

I am Larry D. Crabtree, a partner in the law firm of King & Ballow, which maintains its principal office in Nashville, Tennessee, and a branch office in San Diego, California. I am the partner in charge of our Tax Section, which section is responsible for legal matters involving tax, pension and securities law.

Personal Background

Following my graduation from the University of Tennessee College of Law in December, 1975, and after becoming licensed to practice law in Tennessee in April, 1976, I was initially employed as a staff attorney for the Nashville agency of the Fidelity Mutual Life Insurance Company, then headquartered in Philadelphia, Pennsylvania. As a staff attorney for the Nashville agency, I initially assisted specific agents in designing tax, estate planning and pension proposals for their sales presentations to place life insurance and securities products and then took care of the technical and documentation requirements for delivery to the client's personal legal counsel for implementation of those proposals. I also immediately became involved in assisting clients with plan amendments required to comply with the Employee Retirement Income Security Act of 1974 (ERISA), which required amendments for most plans beginning in 1976.

In early 1978, I was promoted to manager of the Nashville agency's pension department which, together with the Fidelity Mutual home office, provided third-party administrative services to clients with retirement plans. Shortly thereafter, I was appointed to Fidelity Mutual's national Benefit Plan Service (BPS) Committee, consisting of 30 pension department managers from key Fidelity Mutual agencies, and then to the BPS Executive Committee, consisting of six pension department managers. As a member of the BPS Executive Committee, I was directly involved in Fidelity Mutual's ongoing development of prototype plan documents for compliance with ERISA and the regulations thereunder, and in developing and modifying the pension administration computer program. As a part of Fidelity Mutual's process of decentralizing pension administration to the larger agencies, I received extensive training in pension actuarial concepts and funding methods.

In 1983, I was recruited by the law firm of King & Ballow to be responsible for its pension sub-section and to assist clients in restating their qualified plans for compliance with the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), which restatement process soon included compliance with the Deficit Reduction Act of 1984 (DEFRA) and the Retirement Equity Act of 1984 (REA). I was made a partner on November 1, 1984, and was placed in charge of the firm's Tax Section coincident therewith.

Chronology of Lundberg Involvement

In early April, 1986, I was contacted by Mr. David Boatright, an Enrolled Actuary with whom I had worked on pension matters for other clients, with respect to a specific and technical legal research matter involving a plan spinoff issue. At first, I had been given a generic set of facts and had been requested to research the issues in order to render an opinion directly to Mr. Boatright. Within a couple of days, Mr. Boatright provided me with certain specific details regarding the transaction in which Mr.

Thomas Lundberg and Lundberg Industries, Ltd. (hereinafter "Lundberg Industries") had acquired an operating division from Ideal Basic Industries, Inc. (hereinafter "Ideal") and had assumed sponsorship and responsibility for three defined benefit pension plans.

The initial issues involved the valuation of certain irrevocable commitments under a group annuity contract issued by the Aetna Life Insurance Company (hereinafter "Aetna") and the treatment of those irrevocable commitments and the assets attributable thereto under circumstances involving what Mr. Boatright had understood to be a spinoff of the three pension plans assumed by Lundberg Industries from a larger pension plan maintained by Ideal with respect to all of its divisions. The basic problem was that Mr. Lundberg and Lundberg Industries had been operating under the impression that the three pension plans being assumed contained not only assets sufficient to satisfy all liabilities to participants and beneficiaries, but also assets in excess of those liabilities which would be surplus assets in the event of the termination of those three plans. That understanding proved to be wrong, as was discovered soon after Lundberg Industries assumed sponsorship of the three plans and Mr. Lundberg and John Sanders, Esq., were appointed as successor trustees in substitution of the prior trustee, First Interstate Bank of Denver (hereinafter "First Interstate").

Pursuant to the change in trustees, First Interstate proceeded in January, 1986 to transfer the assets of the three plans to Messrs. Lundberg and Sanders. In anticipation of the pending assumption of the plans by Lundberg Industries, First Interstate had notified the Aetna in December, 1985, that its group annuity contract (hereinafter the "contract") encompassing the three plans was being terminated. In response thereto, the Aetna released all assets except those that it had calculated that it was entitled to retain under the contract for the purpose of eventually satisfying the irrevocable commitments that it had previously made to a majority of the participants under the plans attributable to certain benefits which had accrued prior to 1975. Pursuant to Aetna's interpretation of its contract and application of factors expressly stated in the contract or determined internally by Aetna and referenced in the contract, the Aetna retained assets valued in excess of $9 million for the purpose of eventually satisfying irrevocable commitments for benefits, the value of which under factors set forth in the plans was slightly in excess of $7 million. Since the more than $2 million difference was not available to satisfy benefits not subject to those irrevocable commitments, the plans went from having a perceived aggregate surplus of more than $1 million to having an aggregate deficit of more than $1 million, a difference directly attributable to the difference between the benefit obligations and the assets retained by the Aetna under its contract.

If Lundberg Industries' takeover of the pension plans had been accomplished by spinoffs from a larger Ideal pension plan, then it would have violated ERISA regulations for the spunoff plans to have received assets which were less than the liabilities they received. In my opinion letter to Mr. Boatright, I advised that the irrevocable commitments and the assets attributable thereto under the Aetna contract should have been segregated out in determining the balance of assets which should have been transferred from the Ideal pension plan pursuant to the plan spinoffs. My letter was forwarded by Mr. Boatright to the legal counsel for Ideal, who subsequently called me to advise that, while my opinion appeared correct based upon the assumed facts, the fact was that the three plans had not been spunoff from a parent plan, but that Lundberg Industries had assumed three separate and distinct plans in their entirety, together with any asset deficit that existed.

When I advised Mr. Boatright of the response I received, he and I next focused our attention on certain representations which had been made by Mercer-Meidinger, Inc. in December, 1985 as to the existence of surplus assets under the plans. In early June, 1986, Mr. Boatright, Mr. Sanders and Mr. Dave Donaldson, an insurance agent with CNA, met with me and members of my firm regarding the possibility of pursuing an action against Mercer-Meidinger, Inc on account of those representations which Mr. Lundberg and Mr. Sanders had relied upon in negotiating with Ideal for the purchase of its division and the assumption of those plans. Mr. Sanders directed us to send all communications regarding the plans and the lawsuit through Mr. Donaldson.

After our firm began research and preparation in contemplation of bringing an action against Mercer-Meidinger, Inc., Mr. Boatright advised me in July, 1986 that discrepancies had been found in the benefit obligations for which Aetna was responsible under its irrevocable commitments, as evidenced by benefit records taken over from Ideal as compared to calculations made by the Aetna. After a full audit of Ideal's benefit records and many phone calls and letters to and from the Aetna, a meeting was scheduled in Hartford, Connecticut in or about August, 1986 to attempt to reconcile the differences. Mr. Sanders, Mr. Donaldson, Mr. Boatright, one of Mr. Boatright's assistants and I attended such initial meeting at which we also raised the issue of Aetna's possibly releasing a portion of the more than $2 million by which the assets it had retained under its contract exceeded the benefit liabilities for which it was obligated. Mr. Boatright also obtained from Aetna's actuaries certain information regarding their experience under similar contracts for purposes of placing a current value on the future participation rights inuring to the benefit of Lundberg Industries' pension plans under the Aetna contract. The meeting culminated on a positive note.

During this same period from our meeting in June 1986 to the meeting with Aetna in August, 1986, our firm also assisted Lundberg Industries in taking actions to freeze benefit accruals under the three pension plans in order to avoid increasing benefit obligations creating an even larger asset deficit. While Mr. Lundberg and Mr. Sanders apparently originally intended to terminate the three pension plans to obtain a reversion of the more than $1 million surplus which Mercer-Meidinger, Inc. had represented would exist upon termination, the asset deficiency made that impossible, and freezing the plans appeared to be the only viable solution at that time.

Following the plans being frozen, Mr. Boatright had suggested the possibility of spinning off certain benefit obligations from each of the three plans, together with assets equal thereto, to a spinoff plan to be established for such purpose. Thereafter, the original three plans were to be terminated with the assets remaining thereunder distributed in satisfaction of the participant benefits which had not been spunoff. While our law firm agreed that this action would consolidate plan administration down to a single plan, we did not believe this action could result in any reversion to Lundberg Industries since the asset deficit would still exist, although partially reduced by the current value of participation rights under the contract. The information Mr. Boatright had requested from the Aetna in order to value participation rights under the contract was necessary for his use in calculating the value of other assets which would have to be transferred to the spinoff plan, together with benefit liabilities.

After many phone calls and much correspondence to and from the Aetna, accompanied by information on benefit obligations, another meeting was scheduled in Hartford to determine if the benefit discrepancies could be resolved and a settlement obtained from the Aetna. While some progress was made in resolving the discrepancies, the problems remaining greatly exceeded the problems resolved. At the end of the second day of meetings, a vice president of Aetna offered a non-participation conversion under which certain funds would be released from the contract which would then be converted from a participating contract to a non-participating contract. When pressed by Mr. Sanders as to the dollar amount which could be expected to be released, the Aetna vice president replied that Aetna had released funds with respect to certain benefits it should have retained while retaining assets with respect to benefits it should have released, and he could not positively state a specific figure until Aetna determined the monetary impact of its errors.

Mr. Sanders became incensed at this response and indicated that there was no reason to continue discussions. Mr. Sanders and Mr. Donaldson changed their plans to return to Dallas and, instead, returned with Mr. Boatright and me to Nashville, Tennessee to facilitate a meeting the following day at our law firm regarding his intent to sue Aetna. Mr. Sanders made the decision that we should delay filing a lawsuit against Mercer-Meidinger, Inc., in order to devote our attention to the Aetna lawsuit.

The Aetna lawsuit was to be premised partly upon Aetna's failure to correct its errors but largely upon the theory that Aetna was a fiduciary to the plans under its contract on account of its discretion and control over plan assets and the fact that it violated its fiduciary duty by retaining excessive assets for its own benefit rather than applying them for the exclusive benefit of participants.

While our firm advised Mr. Sanders that we believed the better cause of action existed against Mercer-Meidinger, Inc., he insisted we pursue the action against Aetna. Therefore, a complaint was filed in New Mexico against Aetna in late October, 1986. We did, however, convince Mr. Sanders to permit us to write to Mercer-Meidinger, Inc. to communicate our concerns regarding errors we believed had existed in their methods in arriving at the conclusion that surplus assets would exist if the three plans had terminated and in representing such facts to Messrs. Lundberg and Sanders.

Following our filing the complaint against Aetna, by mutual agreement of the parties, the response date for Aetna was extended to permit settlement negotiations. Thereafter, much information changed hands and two or three meetings were held in the latter part of 1986 and the early part of 1987 at which significantly greater efforts were made by the Aetna to reconcile the discrepancies.

During the process of our settlement negotiations with Aetna, our firm was advised by local counsel for Lundberg Industries in Carlsbad, New Mexico, that a lawsuit had been filed on December 1, 1986, against Mr. Lundberg and Lundberg Industries by more than 50 former employees of Ideal, as third party beneficiaries of the asset purchase agreement between Mr. Lundberg and Ideal, alleging breach of that contract as it related to certain health and retirement benefits to which they claimed they were entitled under the terms of the asset purchase agreement. Together with local counsel in New Mexico, we filed a response to their complaint.

Also, during December, 1986, Mr. Boatright called me regarding a proposal to use certain of the assets of the plans for a loan to a third party for use in his acquiring certain real property from Mr. Lundberg. I advised that the proposed transaction would constitute a prohibited transaction under ERISA. He advised me to expect another call from an attorney in Dallas who was working with Mr. Lundberg on the proposed real estate transaction. When I received the call from that attorney, I also advised him that the proposed transaction would be prohibited. Several days later, I had an additional conversation with Mr. Boatright followed by a conference call with him, the Dallas attorney and Mr. Sam Longo, during which I reiterated that the proposed transaction could not be structured as desired because the use of the pension funds would constitute a prohibited transaction. I suggested that the third party should seek alternative financing to acquire the property from Mr. Lundberg, and that it might be possible following an extensive passage of time, when the transaction involving the purchase from Mr. Lundberg might be considered "old and cold," for the plans to loan that unrelated third party funds for the purpose of developing that property, provided there was no agreement in advance that would so commit the plans to such future transaction so that the two transactions would be collapsed into a "step" transaction. I also indicated that, without further research, I could not guarantee that even the passage of time would remove a taint from the second transaction.

I received no further inquiries regarding the proposed lending of plan funds for the purpose of facilitating the sale of Mr. Lundberg's real property to any third party. However, in reviewing evidence in preparation for my testimony in the criminal trials of Messrs. Lundberg and Sanders earlier this year, I noted that they had proceeded with a transaction involving plan funds and an entity called 127, Inc., with respect to Mr. Lundberg's real property, within approximately one week of the time I had advised against such transaction.

Following one of the meetings with Aetna in Dallas, Texas, in February, 1987, an additional issue was brought to my attention by Mr. Boatright when he and Mr. Donaldson were driving me to the airport to return to Nashville. Mr. Boatright mentioned that there had been a sale of certain Lundberg Industries stock to one of the three pension plans. When I expressed my concern that such sale probably fell within the prohibited transaction rules, he stated that he believed that such transaction came within the exception which permitted a plan to acquire employer stock or securities within certain limitations. I advised that it was my opinion, without further research, that such exception was not available under the circumstances involving the plans Lundberg Industries had taken over. I also stated that, since they had not requested my opinion before consummating the transaction, I did not believe they really cared to hear my opinion after the fact, but suggested that the Plans' stock acquisition should probably be reported as a prohibited transaction on the IRS Form 5500 for the year in which it was involved.

Approximately one to two weeks later, Mr. Boatright sent me photocopies of certain ERISA provisions under which he believed the stock sale fell within the exceptions to the prohibited transaction rules. I called Mr. Boatright to advise him that I did not believe the specific exemption applied because the plans were not eligible individual account plans, but that the issue was not one with respect to which the client had requested that I provide an opinion, so I suggested that he obtain permission from the client if he desired that I more fully review the matter and provide an opinion to him for purposes of his firm's completing the annual report/return for the subject plan.

As with the transaction involving 127, Inc., in preparing for my testimony in the criminal trial of Messrs. Lundberg and Sanders, it came to my attention that the employer stock in question had subsequently been resold to Lundberg Industries within one to two months after Lundberg Industries had sold the stock to the plan. However, the information available indicated that the resale was for precisely the same amount as the sale to the plan so that the plan made no profit on the transaction. There appears no way that the stock transaction could have been deemed to be a use of plan assets by the trustees "for the exclusive benefit of participants and beneficiaries." In fact, even if the original sale to the plan had fallen within an exemption to the prohibited transaction rules, the resale of the stock to the employer, especially at no profit, was clearly a prohibited transaction. As indicated above, I had not been consulted prior to the sale of the stock to the plan; neither was I consulted on the resale of the stock to the employer.

In early March, 1987, I first travelled to Carlsbad, New Mexico, together with local New Mexico counsel, Brian Copple, Esq., for our initial pre-trial conference with W. T. Martin, Esq., who represented the numerous former Ideal employees in their suit against Mr. Lundberg and Lundberg Industries. Mr. Copple and I were accompanied to that pre-trial conference by Dick Horton, Esq., who was the personnel director for Lundberg Industries.

Since neither Mr. Copple nor I had ever personally met Mr. Lundberg, we used the opportunity of the pre-trial conference in Carlsbad to schedule a meeting with Mr. Lundberg on the second day of our visit there. On the morning of that second day, Mr. Horton met us for breakfast so that he could take us to the potash mines and the offices and physical plant of Lundberg Industries for the meeting with Mr. Lundberg. At our breakfast meeting, Mr. Horton made a casual comment regarding benefit distributions which had been made to participants in either late December, 1986, or early January, 1987, pursuant to the termination of the three plans. I expressed my extreme shock at the fact that plan termination distributions had occurred, since I had not yet filed the required notices of intent to terminate with the Pension Benefit Guaranty Corporation (PBGC).

We then proceeded to meet with Mr. Lundberg for our originally intended purpose of ensuring that Mr. Lundberg was fully informed as to the costs and complexity of the Aetna litigation and as to the possible chances of prevailing on the respective issues involved. Mr. Copple and I had both been concerned as to the lack of direct contact with Mr. Lundberg, and we were not certain that all of our concerns regarding the Aetna litigation were being conveyed to him by Mr. Sanders. I also wanted to communicate our lawfirm's opinion that the cause of action against Mercer-Meidinger, Inc. was the better cause of action with a greater likelihood of prevailing, so that we should be permitted to proceed with commencing that action.

I then questioned Mr. Lundberg regarding the fact that plan termination distributions had occurred, and advised that I had not filed the required notices of intent to terminate with the PBGC, nor had I been advised as to the plan distributions. Mr. Lundberg stated that Mr. Sanders and Mr. Boatright had assured him that all distributions had occurred under proper circumstances. I advised him that I would investigate the matter with Messrs. Sanders and Boatright.

Upon returning to Nashville, my office informed me that my presence was requested at a meeting at Mr. Boatright's offices with Messrs. Sanders and Donaldson, as well as Mr. Boatright's staff, for the purpose of attempting to arrive at a finite listing of all the problems with the Aetna. I confronted Messrs. Sanders and Boatright with the question of benefit distributions having occurred without my knowledge and without my having completed the required filings with the PBGC. I was informed that Mr. Sanders had made the decision in September, 1986, to have Mr. Boatright make the necessary filings with the PBGC so that I could devote my attention to the Aetna litigation. I expressed my outrage at not having been kept informed as to transactions which could have an effect on the litigation and negotiations. I also advised that problems existed with the purported spinoff plan transaction, followed by terminations of the three remaining plans, because I had not completed the spinoff plan document since I was not aware that it had yet been required. After Mr. Sanders left that day, Mr. Donaldson apologized to me for not having communicated the facts as to what had occurred, but advised that he was simply following orders. On that day, no one volunteered the fact that a reversion of plan assets to Lundberg Industries had also already occurred.

Because we needed a definitive listing of benefit problems with the Aetna and had not yet gotten that from Mr. Boatright's staff, I personally took all benefit data and worked with one of Mr. Boatright's senior staff members in arriving at a finite list of problems to present to the Aetna for correction and/or explanation. That initial listing was followed by a supplementary listing of certain additional problems brought to my attention.

During the ongoing negotiations with the Aetna, Mr. Boatright had also sought from other insurance companies premium quotations on the cost of providing the identical benefits for which Aetna had issued irrevocable commitments and for which it was retaining plan assets. Mr. Boatright had obtained several quotes, the best of which was a premium quote under seven million dollars for providing the same benefits for which the Aetna was retaining in excess of nine million dollars. We used these figures as leverage in seeking to obtain a larger release of funds from the Aetna in the conversion of the contract to a non-participating basis.

After our lawfirm had received permission from Mr. Lundberg to proceed with research in preparation for filing the action against Mercer-Meidinger, Inc., we proceeded with our review of the law, regulations and the legislative history to ERISA, in particular on the issue of an insurance company possibly being considered a "fiduciary" under ERISA. We were convinced that the legislative history demonstrated that Congress had intended that insurance companies could be ERISA fiduciaries, even though Department of Labor (DOL) regulations promulgated under ERISA stated that generally insurance companies would not be deemed ERISA fiduciaries under normal circumstances involving group annuity contracts. Because we were concerned with having to overcome the position expressed in the DOL regulations, we were ecstatic when a decision was reported, Jacobson v. John Hancock Insurance Company, which held the insurance company to be a fiduciary with respect to the plan under which it had issued a group annuity contract. My review of the contract issued by the Aetna under the three plans sponsored by Lundberg Industries convinced me that the Aetna had sufficient control, pursuant to the terms of its contract, over the disposition of assets held on behalf of the plans to make it a fiduciary as defined in ERISA Section 3(21). I found three specific instances under the contract in which the Aetna could control the amount of funds available for release upon contract discontinuance which I believed constituted sufficient control or discretion.

We also proceeded, in accordance with Mr. Lundberg's authorization, to complete our research in preparation for commencing an action against Mercer-Meidinger, Inc. based upon theories of either actuarial malpractice or negligent misrepresentation. Because we knew an expert witness would be required on the issue of standard of care for actuarial practice, we contacted and received the agreement of Mr. Ira Cohen to be engaged as our expert witness for such purposes. Mr. Cohen is the former Chief of the IRS Technical and Actuarial Branch, currently associated with Price Waterhouse in Washington, D.C. Based upon his preliminary review of the facts we presented, Mr. Cohen indicated that his threshold opinion was that we appeared to have a sound case with a fairly good likelihood of prevailing.

In order to prepare the complaint against Mercer-Meidinger, Inc., I and two members of my firm, Steve Douse, Esq. and Ken Douthat, Esq., travelled to Dallas, Texas, to meet with Messrs. Lundberg, Sanders and Donaldson to interview them regarding their recollections of the events leading to Mr. Lundberg's acquisition of the company from Ideal and the representations which had been made by Mercer-Meidinger, Inc. regarding the pensions upon which they had relied. We scheduled Mr. Lundberg for the morning of the first day and Mr. Donaldson for the afternoon of the first day, so that when we interviewed Mr. Sanders the morning of the second day, we would be prepared to question him if his recollections differed from those of Messrs. Lundberg and Donaldson. Our interview with Mr. Lundberg was interrupted by his receiving a call from Mr. Joe

Wall, a CNA insurance agent in Nashville, Tennessee, regarding his having been contacted by an attorney for Ideal seeking information regarding a transaction which had occurred between him and the plans. Mr. Lundberg requested that I speak with Mr. Wall; whereupon, I informed Mr. Wall that I could not represent him because of the potential for a conflict, but indicated that he should consult with his personal legal counsel regarding the fact that he should not have to provide any information or documents to the other attorney absent his receiving a subpoena. That morning in April, 1987, was the first time I became aware that there had been a transaction between the plans and Mr. Wall and, even then, I was not fully informed as to what had transpired. Mr. Wall did indicate that he had received a loan from the plans, had purchased certain equipment from Lundberg Industries and had leased the same back to Lundberg Industries, but did not indicate the precise amount of money involved. While we had not been employed by Lundberg Industries at the time the transaction had occurred and had not been consulted regarding the same, I decided I would have to confer with the other attorneys in my firm regarding how the transaction might possibly have an effect on the litigation in which we were involved and how it might create problems.

Because Mr. Lundberg and Lundberg Industries was involved in other litigation with Ideal being handled by a Dallas lawfirm, we also scheduled a meeting that first day in Dallas with Don Templeton, Esq., of that firm to discuss how their possible settlement of that lawsuit could affect our defense of the lawsuit brought by former Ideal employees against Lundberg Industries for breach of the asset purchase agreement with Ideal. We wanted to ensure that settlement with Ideal would not preclude our defending the lawsuit by their former employees on the theory that Ideal was liable for the health and retirement benefits for which they had made a claim. After we had discussed the issues related to both lawsuits, Mr. Templeton inquired as to what our knowledge was of a transaction in which several million dollars had been transferred to Lundberg Industries from the pension plans it had sponsored. We advised him that such information had not previously been made known to us and that we would use the opportunity of the upcoming interview of Mr. Sanders on the following morning to question him regarding this matter. I believe it was Mr. Templeton who also gave us additional insight into the transaction in which Mr. Joe Wall had used the proceeds of a plan loan to purchase equipment from Lundberg Industries, pledging that equipment as security to the plans even though such equipment was already pledged as security under the asset purchase agreement with Ideal.

After the meeting with Mr. Templeton, we met that evening to plan our strategy for the interview with Mr. Sanders the following morning. The next day, after having obtained Mr. Sanders' statement regarding the negotiations and purchase from Ideal and the reliance on representations by Mercer-Meidinger, Inc., we raised the issue of the plan reversion having occurred without our knowledge and under circumstances which violated the joint implementation guidelines established by IRS, DOL, and PBGC. I informed Mr. Sanders that Mr. Boatright had, within the week, given me a letter from the PBGC which had been written to Mrs. Lundberg, as Plan Administrator, requesting advice as to when guaranteed annuity contracts would be purchased for all participants under the terminating and/or spinoff plan to provide for their benefits which had not been distributed in cash. I advised him that I had initially intended to respond to the PBGC letter by stating that the joint implementation guidelines were not applicable and the plans were not required to purchase guaranteed annuity contracts, because no reversion to the employer was occurring. I stated that that response was no longer possible because a reversion had already occurred and that I would have to refer the matter back to Mr. Boatright for him to handle, because the circumstances left me with no valid response to the PBGC. I reminded Mr. Sanders that he had taken from me the responsibility for the PBGC filings and had given it to Mr Boatright and that I had never been provided with any copies of the PBGC filings in which any proposed reversion would have been stated. I advised him that I saw no solution to the problem other than the immediate purchase by Lundberg Industries of the annuity contracts necessary to guarantee the benefits of participants and beneficiaries who had not received cash distributions.

We also advised Mr. Sanders that the fact of the reversion having occurred severely compromised our positions in the ongoing litigation with the Aetna and the proposed litigation against Mercer-Meidinger, Inc. In the Aetna litigation, the action was partly premised upon Aetna's breach of its fiduciary duty, and the fact of the reversion having occurred would leave Mr. Lundberg and Lundberg Industries in the position of going into court with "unclean hands." In turn, the proposed lawsuit against Mercer-Meidinger, Inc. was predicated on the fact of Mr. Lundberg and Lundberg Industries having been damaged by reliance on Mercer-Meidinger's representations that surplus assets of slightly more than $1 million would be available for a reversion upon plan termination, when the plans were actually underfunded. Because Lundberg Industries had actually received a reversion of several million dollars, although under improper circumstances, that fact made it difficult to proceed with the lawsuit, the basis for which was that Lundberg Industries was not receiving the reversion it had expected. That lawsuit would, of course, have been returned to a sound footing if Lundberg Industries had been required to take the funds it had received in reversion plus additional assets to purchase annuities required to fund all benefits.

One of the most serious considerations I posed to Mr. Sanders was the violation of the joint implementation guidelines promulgated under ERISA. I advised that PBGC had been given sufficient authority by Congress to set aside the plan terminations and require the return of the plan assets which had reverted to the employer. At that time, we were not aware of the severe financial difficulties under which Lundberg Industries was operating and the fact that all those reversion assets had already been disbursed from the corporation to various parties.

I also expressed to Mr. Sanders my problem with the concept that a reversion had occurred when we were aware that an asset deficit existed. He stated that the reversion had been created when Mr. Boatright had placed a value of several million dollars on the participation rights under the Aetna contract when that contract was purportedly spun off to a separate plan. I stated that I saw no way that those participation rights could be valued in such a manner to generate a figure of several million dollars, when the Aetna had offered to release only seven hundred thousand dollars in satisfaction of those rights in a conversion to a non-participating contract. Mr. Sanders stated that we should make sure that Mr. Boatright was adequately protected with respect to his involvement in the transactions. I advised Mr. Sanders that our firm did not represent Mr. Boatright and that our concerns related to the integrity of the plans and how the transactions might adversely affect the ongoing and pending litigation.

Following our return to Nashville, I contacted Mr. Boatright and advised that I could not handle the response to the PBGC regarding the issue of the required purchase of annuities, and Mr. Boatright stated that he would take care of the matter. I initially thought Mr. Boatright meant that he thought he could convince PBGC not to require the purchase of annuities, and I had advised him that I was aware of no way that would be possible. Through a subsequent conversation, I came to understand that he had intended to simply request from PBGC additional time within which to purchase the required annuities in contemplation of the hoped-for settlement of the Aetna litigation for an amount which would make available the necessary funds to purchase required annuities. However, during the negotiations with Aetna, I had advised the individuals on our side that the best possible settlement I expected from the Aetna was in the range of $1.2 million. In fact, toward the end of the negotiations, I had provided Messrs. Lundberg and Sanders with a written opinion that I believed that if we could get the Aetna to raise its settlement offer from approximately $700,000 to somewhere in the range $950,000, the offer should probably be accepted because of the substantial litigation costs anticipated if the case went to trial and the fact that the outcome of the litigation could not be guaranteed. It is my understanding that PBGC did, in fact, eventually settle the litigation with Aetna for approximately $900,000.

Also, after returning to Nashville from the pre-litigation interviews in Dallas, our lawfirm held a meeting of all attorneys involved in the Lundberg matters to discuss the problems discovered in the Dallas meetings and to determine how we should proceed under the various matters. We began to review the applicable disciplinary rules issued by the Tennessee Supreme Court and the ethical considerations raised by the problems, as well as researching the case law in preparation for filing an opinion request with the Disciplinary Board for the State of Tennessee.

We prepared communications to Messrs. Lundberg and Sanders advising that we believed that it was absolutely necessary either for Lundberg Industries to return to the plans the assets it had received in the impermissible reversion or to proceed with the purchase of annuity contracts guaranteeing the benefits for all participants and beneficiaries who did not receive cash distributions. At some point during this process, we received notice that Lundberg Industries had filed for protection under the bankruptcy laws. Because the offices of Lundberg Industries in Dallas had been moved without our knowledge, we were not certain as to whether certain letters regarding discovery issues in the Aetna litigation and other plan matters had been received by Mr. Lundberg. In turn, we placed numerous calls to Mr. Lundberg and Mr. Sanders but were unable to reach them and could not get them to return our calls.

In response to our filing a request for an opinion from our Disciplinary Board based on an outline of the circumstances, we received a reply which stated that not only must we withdraw from representation in the ongoing litigation and other matters, but that we should also communicate with the participants and the beneficiaries of the plans to advise them of the problems, if we determined that an ongoing fraud was occurring. We immediately consulted with our local counsel in New Mexico and then proceeded to file motions to withdraw from the litigation involving Mr. Lundberg, Lundberg Industries, Mr. Sanders and the plans.

Soon after Lundberg Industries had filed for bankruptcy protection, we were notified that the bankruptcy judge had appointed a bankruptcy trustee, rather than allowing Lundberg Industries to proceed as a debtor in possession. We also were made aware that PBGC had moved to take over the three pension plans because of the failure of Lundberg Industries to properly provide for the purchase of guaranteed annuity contracts. With the occurrence of these latter circumstances, we believed that adequate protections were in place for the participants and beneficiaries under the plans so that we had no duty to directly communicate to them the problems of which we had become aware.

In the latter part of 1987, I was contacted by the bankruptcy trustee, David Elmquist, Esq., for assistance in his becoming familiar with the ongoing litigation and determining the manner in which the lawsuits should be handled. I immediately advised Mr. Elmquist that the statute of limitations might possibly be running on the cause of action against Mercer-Meidinger, Inc., and that immediate action would be required to preserve any possible recovery in that matter. After several conversations, Mr. Elmquist moved for and obtained my appointment as special counsel to the bankruptcy trustee to assist in proper disposition of the ongoing litigation and completion and filing of the complaint against Mercer-Meidinger.

In late 1987, I was noticed by PBGC for deposition and production of documents with respect to the civil litigation they had instituted against Mr. Lundberg, Mr. Sanders and other individuals. After reviewing the caselaw provided by PBGC, we determined that PBGC, as successor plan trustees, could waive any attorney-client privilege which might exist between our lawfirm and Messrs. Lundberg and Sanders, as former plan trustees. In addition to providing my deposition in the civil litigation, I was subpoenaed to and did testify in the criminal trial of Messrs. Lundberg and Sanders earlier this year for their alleged criminal violations of ERISA.

Summary

In my opinion, the problems experienced by Mr. Lundberg and Lundberg Industries with respect to the three pension plans he had taken over arose out of the failure of Mr. Sanders to include in the asset purchase agreement with Ideal an appropriate representation and warranty as to the existence of the potential surplus assets as represented by Mercer-Meidinger, Inc. However, that failure on Mr. Sanders' part was in no way involved in the parties engaging in the prohibited transaction with Mr. Joe Wall in January, 1986. On the other hand, I believe it had much to do with Mr. Sanders' posturing with regard to the matters involving the Aetna, as well as his decision to have us delay our filing of the lawsuit against Mercer-Meidinger, Inc.

I have no explanation for why the Dallas attorney who had consulted with me regarding the proposed transaction eventually involving 127, Inc. proceeded to document the transaction as he did after having received my advice against proceeding as planned. I have since become aware that Mr. Lundberg's relationship to that entity had been terminated and that other changes in ownership of other entities had occurred, apparently in response to my having explained the rules defining a "party-in-interest" under ERISA. Even though I had counselled against either a direct or indirect lending to or use of plan assets for the benefit of a party-in-interest, they apparently perceived the changes in ownership of various entities as clearing the way for that transaction. They definitely did not wait for a significant passage of time to perhaps remove the "taint" from that transaction on account of Mr. Lundberg's prior relationship with 127, Inc. or the other entities.

With respect to the impermissible sale of the Lundberg Industries stock to one or more of the plans, I am of the opinion that Mr. Boatright honestly believed the initial transaction was permissible under the exemptions to the prohibited transaction rules. However, we never discussed the eventual resale of that stock from the plans back to Lundberg Industries, so I have no knowledge as to whether he thought the resale without any profit to the plans was permissible. In any event, I believe Mr. Boatright was confused by a very complicated section under ERISA.

With respect to the impermissible reversion of plan assets which had occurred in violation of the joint implementation guidelines, as I had stated in my response to cross-examination by Mr. Sanders' attorney in his criminal trial, had I been permitted to remain responsible for the filings with PBGC, I would have been controlling the termination process to ensure that it proceeded properly and would have, hopefully, been able to prevent the impermissible reversion from occurring. It is my understanding, from having at one point spoken with Mr. Boatright's attorney in the criminal proceedings and having been informed as to certain matters in preparation for my testimony in the trial of Messrs. Lundberg and Sanders, that Mr. Boatright had written to Messrs.

Lundberg and Sanders to advise them that the purchase of guaranteed annuity contracts was absolutely required because of the reversion of assets to Lundberg Industries pursuant to the plan terminations.

Since I did not hear nor have I seen Mr. Boatright's testimony in the criminal proceedings, I do not know if he knew in advance that the reversion of assets from the plans had been intended immediately following the distribution of cash benefits to part of the participants under the plans. From my discussions with Mr. Boatright in either April of May of 1987, I do know that he was aware of the requirements under the joint implementation guidelines.

Conclusion

I wish that I could tell this Subcommittee that I had the absolute solution to problems under ERISA in the nature of those involved in the Lundberg situation. However, I do not.

While suggestions might be made as to certain additional reporting requirements, such as a requirement that a prohibited transaction be disclosed to IRS, DOL or PBGC on a specific form within thirty to sixty days of its occurring, rather than on the annual report/return which is due at the end of seven months following the plan year in which the prohibited transaction might have occurred, that would simply add to filing requirements which are already extensive and considered unduly burdensome by a large number of taxpayers. Alternatively, certain additional licensing requirements might be imposed on practitioners who work in the qualified plan area and provide consultation or documentation with respect to qualified plans or any transaction in which a qualified plan is involved.

I might also suggest that certain licensing requirements be imposed on any life insurance agent or securities broker who either sells products to or receives any compensation either directly or indirectly with respect to any transactions or investments involving qualified plans. I have, all too often, seen situations where problems in qualified plans had in some way been created by the involvement of either an insurance agent or a registered representative of a securities broker who knew just enough about qualified plans to be what I would consider "dangerous."

I believe that additional requirements should be imposed on insurance companies whose products are sold to qualified plans. In my opinion, the latitude given to insurance companies under their group annuity contracts is far greater than that which it should be. Guidelines should be set forth to more clearly delineate the responsibilities of insurance companies to ensure that when they hold plan assets under group annuity contracts, those assets are administered for the exclusive benefit of plan participants and beneficiaries. It is a gross injustice to qualified plans, when they attempt to terminate group annuity contracts, to allow the insurance companies to use questionable contract language and internal factors in determining what funds the insurance company, in its sole discretion, will return to the plans upon contract discontinuance. The use of the insurance company's "old money rates" in lieu of their "new money rates" to determine what they will release to the plan creates a serious inequity and potential harm to plan participants and beneficiaries. If insurance companies were required to quote for contract discontinuance benefits in the same manner that they quote premiums for new business, I suggest that an enormous amount of funds could be made available to offset potential liabilities for which the PBGC ultimately becomes liable. I do not understand why the PBGC did not pursue the issue of the fiduciary status of the Aetna in regard to the group annuity contract under the Lundberg Industries' pension plans.

In conclusion, I encourage this Subcommittee in its endeavors to arrive at solutions to the perceived problems in ERISA administration and enforcement. I thank you for the opportunity to speak before this respected body and present my views.

Chairman **Pickle**. I thank you, Mr. Crabtree.

I did not say to you, but I want to make it plain to you and others, that your statements, all of them, will be included in their entirety for the record. So we are asking you to condense your statement. But the full statement will be included.

Now we are going to hear from the next witness, who will be Mr. Warren Hardin, Bud Hardin. He was a plan participant, and I think generally credited for assisting in obtaining facts and information on this plan.

So, Mr. Hardin, will you proceed.

STATEMENT OF WARREN (BUD) HARDIN, PRESIDENT, INTERNATIONAL ASSOCIATION OF MACHINISTS & AEROSPACE WORKERS, LOCAL 1265, CARLSBAD, N. MEX., AND PARTICIPANT, LUNDBERG INDUSTRIES LTD. PENSION PLAN

Mr. **Hardin**. Mr. Chairman, distinguished members of the committee, I am Bud Hardin. I am from Carlsbad, N. Mex. I want to thank you for the opportunity to appear and testify before this committee.

Let me tell you that I am a victim of a conspiracy operated by a former owner to deplete the assets of our pension plan. I feel that anything that can be done must be done to prevent this type of thing from occurring. This affected people in my community, myself personally and others, deeply and in a lasting way. It must be prevented if at all possible.

Let me tell you that despite our best efforts this man operated a scam, took money from our pension plan. We attempted to prevent him in every way that we knew how once we became aware that he wasn't doing what he said he was going to do.

The man came in and told us that he had to terminate the pension plan, that he was unable to operate the pension plan, and then went through the motions of appearing to do so in what we felt was a legal and forthright manner, and found out later to our disadvantage that he did not.

Early on we contacted—I personally contacted my international union here in Washington and asked them to check it out and find out if there was anything illegal in Mr. Lundberg's operation in terminating the plan, and I was assured through their examination of the paperwork available to them that it all appeared to be legal and in good shape, so we proceeded from that point until the point that it became totally obvious to everyone in the community that something was desperately wrong, and that there were no assets left in the pension plan.

During that time, a group of employees and local retirees filed a lawsuit. We began to petition for a grand jury and got a local grand jury and got indictments through that grand jury. We put pressure—hopefully, we put pressure—on the people in Washington through our Senators' office to attempt to do something, and eventually a Federal investigation began and indictments were received through the Federal courts. The man was tried and convicted, along with his attorney.

Let me tell you that, $350 pension that I personally lost through this man's actions will have a serious effect on my personal life. I am reaching the point where I need to retire, and the money available for me to retire on is gone.

Again, let me tell the committee, I will be glad to answer any questions that I can, but if you do have questions for me, I am slightly hard of hearing, and I would ask you to ask them so that I can hear.

Thank you.

[The prepared statement follows:]

STATEMENT OF WARREN (BUD) HARDIN,
PRESIDENT, INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS, LOCAL 1265, CARLSBAD, NEW MEXICO

Before The Subcommittee On Oversight,
Committee On Ways And Means

June 12, 1990

Good morning Mr. Chairman. I am pleased to be here this morning. My name is Bud Hardin, and I am a journeyman pipefitter working in the potash mines at Carlsbad, New Mexico. I am also President of the local of the International Association of Machinists and Aerospace Workers, representing other machinists at the mine. I have been asked to come here this morning to describe some of what happened to me and my co-workers over the last five years after our mine was bought by Lundberg Industries, and our pensions were terminated.

Our problems began in 1985, when our absentee owner decided it was getting out of the mining business, and began to lay off our people. At the end of that year, after months of lay offs, a buyer was found -- Tom Lundberg. Lundberg was a big wheeler-dealer from Dallas Texas.

Lundberg and his henchmen immediately refused to recognize our labor contracts and told me and other union officials that he planned to negotiate a new contract. He also said he was going to terminate our pension plan, and replace it with individual annuities for plan participants. He told us that all of our pensions would be protected by the annuities. At that time, our main interest was in getting the mine reopened and getting our jobs back. The jobs of some 400 people were at stake, and there was no other work for us to do in Carlsbad.

We were also concerned about our pensions, however, and were suspicious about Lundberg's decision to terminate, and his promise that all of our pensions would be paid. We repeatedly asked for a copy of documents we thought might give us information about how our money was being protected -- summary plan reports, 5500 forms, which are supposed to record information about pension plans, and actuarial working papers. We were promised these documents, but never did get most of them, other than an incomplete unsigned 5500 and the 1984 summary. We also kept asking for information about our pension money: "who are the trustees?"; "where is the money?" We kept getting told not to worry, that everything was OK, that the money was in the bank.

At some point a member of top management approached me at the mine and told me confidentially that he thought something might be wrong, that Lundberg might be stealing money from the pension plan. I contacted my international union in Washington D.C. for help. The union went over all of the papers we had relating to the termination, and told us that the paper checked out, and that everything appeared in order, on paper at any rate.

We relaxed a little, and some partial payments even were made in January 1987. But the company still was not giving us the documents we asked for, and I was still suspicious. So we filed a grievance asking for the information. The grievance got nowhere.

The next thing we know, in June 1987, the company filed for bankruptcy, and we were really in over our heads. Understand that we are a small union local, with only 80 members, a small treasury, and no employees or full-time officers. There is no way we can deal with the Bankruptcy Court, the IRS, the PBGC, the DOL and so on by ourselves. After the bankruptcy, our International Union sent down a full time paid staff person to help us, but even with that help, we still were not finding out anything. And I kept in contact with the Benefits Office of our International Union here in Washington, D.C., but they also were able to tell us only that from the papers we had, it looked like Lundberg was complying with the regulations.

Sometime later it became obvious what was really going on -- in December 1985 Lundberg had bought the mine, and in January 1986 he stole some $2.3 million from our pension. Whatever he had said in the papers he had filed, he was in our pension with both hands and feet, along with his buddies. While he had control of the company he and his wife were paying themselves a pretty salary, a lot of that money apparently coming right out of our pensions. He drove the company right into bankruptcy, in the process spending a lifetime of savings of the company's workers.

The bankruptcy judge found mismanagement and apparent fraud, and we circulated petitions, contacted local politicians, and ultimately got a local grand jury going. The DA ultimately became involved, and we won a 29-count indictment under state criminal law.

I was still pushing for a federal indictment, and with the help of our United States Senator the feds finally got interested. They sent investigators down to the bank to see if there really was anything left of our pensions. Basically there wasn't. The feds had come in too late to save our pensions. Federal indictments followed, and there was a trial. Tom Lundberg and his attorney were convicted, and are about to begin doing time in a country club in New York. An actuary and an insurance agent plea bargained, I believe.

Meanwhile, we still don't have all of our pensions. The PBGC (and the taxpayers) have picked up the tab for some of the pension, but there are still a lot of unanswered questions. Some of our benefits apparently are not guaranteed by the PBGC, and so are just lost. For example, lots of us have so-called "70/80" claims entitling us to pensions as a result of the plan termination or layoffs, and those pensions are gone forever. The PBGC won't pay them.

The case has been assigned to a PBGC case officer, and she even came down to the mine and discussed the case with us. But basically she said she couldn't tell us anything. We have since written numerous letters and claims to the PBGC. For example, our widows were entitled to a "widow's benefit" pension, but they are not getting it. The PBGC won't pay it, and it won't even tell us if it is an insured benefit or not. When we write as a union official for everybody, they won't even talk to us. When we write as individual beneficiaries, we always get a letter back that says "we are thinking about it, we will let you know when we make a decision." But they've had the case for two years now. The DOL, the IRS, the PBGC, somebody needs to do something. To this point, all I've gotten is some nice letters, but that's it.

I'm getting old now, and worn down by this. Maybe if I had the energy level I should, I could one more time start up the process of getting politicians involved, and the PBGC or IRS or DOL or whomever would begin to take the next step. for now the entire experience has been very frustrating, and it has taken a lot of effort to get what little results we have gotten. We had a hunch from the beginning that something was up, but until it was too late we were never able to get the kind of information we needed to see whether our pensions had been stolen. And until it was too late the government took no interest in this situation at all.

The result of all of this is that now, as I approach retirement, the money I earned for my retirement is gone, and the taxpayers are footing the bill for part of it. The rest of the money I had planned to retire on apparently is gone forever. And I don't suspect our case is unique, though it may be one of the few cases in which the thieves have been caught and punished. Anything that could be done to make it more difficult to commit this type of crime would be a great service to all retirees, and to all taxpayers.

I would like to thank the Committee for listening to me, and I would be happy to answer any questions anybody might have about what has happened to us at Carlsbad.

Chairman PICKLE. We are going to proceed with the next witness, but I am sure the committee will have questions for you at a little later point. We thank you for your statement and commend you for your perseverance in trying to get information. If you hadn't done it, I don't believe the case would have developed.

Now, our next witness will be Mr. DeLuche. Mr. DeLuche is chief criminal investigator of the Fifth Judicial District Attorney's Office in Carlsbad.

Mr. DeLuche.

STATEMENT OF DENIS E. DeLUCHE, CHIEF CRIMINAL INVESTIGATOR, FIFTH JUDICIAL DISTRICT, DISTRICT ATTORNEY'S OFFICE, STATE OF NEW MEXICO

Mr. DELUCHE. Thank you, Mr. Chairman.

Upon invitation and with appreciation, I wish to present the following testimony. The Lundberg case was initially brought into our office primarily as an insurance problem and vendor problem, in that Lundberg Industries, after bankruptcy, had ran up a tremendous amount of credit with local vendors. Those particular problems, the insurance problems, the pensioners, of course, not having insurance, that was referred to other agencies.

In August of 1987, PBGC and the inspector general's office of the Department of Labor indicated they were beginning investigations. During that same August date, people like Bud Hardin, members of our community, banded together and prepared a petition for grand jury.

A petition for grand jury in the State of New Mexico is a mandatory proceeding if a sufficient number of voters' signatures is arrived at. They did gather approximately 600 signatures. They requested that the grand jury investigate misappropriation, misuse of pension funds, workmen's compensation funds and various other frauds. That State grand jury did come about, and I will get back to that in just a second.

In late August or early September of 1987, a meeting was held in Santa Fe, N. Mex. between our office, the attorney general's office and the inspector general's office of the Department of Labor. It was initially decided that the Attorney General's office would take the lead because of the magnitude of the Lundberg investigation. The Department of Labor was going to be handling the Federal end, the inspector general's office, our office, would provide support.

It was later determined, and this is contained within my statement, that the attorney general's office, investigative division, was already committed to other activities. Their legal staff would be available when we got into the grand jury information gathered by the inspector general's office Department of Labor, or would be unavailable to me, because it was 6(e) material, in other words, grand jury material that they were gathering themselves. Our particular grand jury was only impaneled for 90 days.

Based on that situation, on October 5, 1987, the district attorney assigned myself to the Lundberg case on a full-time basis. My duties were to coordinate State and Federal activities, and to attempt to gather evidence to proceed in our local grand jury.

A second series of meetings were held with State and Federal authorities. At this time there was a new entity, PWBA. PWBA came into the case, my understanding, to gather evidence for presentation in civil cases for PBGC.

For the next 60 days, I gathered what I felt to be evidence. I took statements, not only from witnesses, but from potential defendants. I gathered approximately 17,000 documents.

In December of 1987, our grand jury came out with an indictment, which is attached for your information. That indictment charged 27 counts on 9 defendants. After the indictment, the material that I had gathered was not grand jury material, in other words, unavailable, was given to the Inspector General's office and PWBA for their civil actions.

During July and August 1988, there was a change of venue in our criminal case to Santa Fe, N. Mex. At that time in Santa Fe, it was determined by the State trial court that the State charges involving the pension fund were to be dismissed based on jurisdiction. It was felt that the State did not have jurisdiction.

In September 1988, all grand jury evidence was made available to the Federal authorities, primarily inspector general's office, and from that time forward, myself and Agent Crowe of the inspector general's office, worked the case from a Federal level. I was actually assigned to the Lundberg case, the Federal entity, for the duration.

The State charges upon Lundberg and Sanders' conviction and the conviction of the other participants, the State charges were dismissed after their conviction.

That is all I have at this time.

Chairman Pickle. Thank you, Mr. DeLuche.

[The prepared statement follows:]

STATEMENT OF
DENIS E. DeLUCHE
CHIEF CRIMINAL INVESTIGATOR
FIFTH JUDICIAL DISTRICT
DISTRICT ATTORNEY'S OFFICE
STATE OF NEW MEXICO

Mr. Chairman and members of the Subcommittee, upon invitation and with appreciation, I wish to present the following testimony:

The Lundberg case was initially brought to the attention of the Office of the District Attorney, Fifth Judicial District, State of New Mexico, in July of 1987. The complaint or series of complaints seemed to focus into two areas: the loss of benefits in insurance claims by employees of Lundberg and; local vendors to Lundberg who had extended large amounts of credit to Lundberg Industries prior to their bankruptcy.

These complaints were referred to the New Mexico Department of Insurance and the Federal Bankruptcy Court in Dallas, Texas.

In August of 1987, it was announced that P.B.G.C. and the Inspector General's Office of the Department of Labor would begin investigations into the Lundberg activities. On August 24, 1987, a petition for a State Grand Jury was filed and docketed. This petition contained over 600 signatures of local residents of Carlsbad, New Mexico. (See exhibit "A").

In late August or early September of 1987, a meeting was held in Santa Fe, New Mexico between our office, the New Mexico Attorney General's Office, and the Department of Labor Inspector General's Office. It was decided that the Attorney General's Office would take the lead on the State investigation and that our office would provide support to them and the Department of Labor.

An Order to convene a Grand Jury at the State level was filed on September 22, 1987. That Grand Jury convened on October 1, 1987. (See exhibit "B").

By October 15, 1987, the following had been determined:

1. That the Attorney General's Office was unable to provide investigative assistance;

2. That their legal staff would be available to present evidence to the State Grand Jury;

3. That information gathered by the Inspector General's Office was not available to this office as it was 6-E material;

4. That our Grand Jury was only empanelled for 90 days.

On October 15, 1987, District Attorney Thomas A. Rutledge assigned me to the Lundberg case on a full-time basis. My duties were to coordinate the state and federal efforts and attempt to gather evidence that could be presented to the seated Grand Jury in Carlsbad, New Mexico.

A second series of meetings was held with Mr. Tom Martin, Attorney-at-Law, Carlsbad, New Mexico. He represented the miners and pensioners who attempted to brief all agencies which now included P.W.B.A. on what he felt were salient facts in the Lundberg case. I was informed that P.W.B.A. was preparing information for P.B.G.C. to be used in civil matters.

For the next 60 days, I obtained evidence from law firms in New Mexico and Texas, the bankruptcy court, the corporate offices of Ideal Basic in Denver, Colorado, the trustee, Mr. David Elmquist and P.B.G.C..

Over 30 individuals were interviewed and taped. Approximately 17,000 documents were obtained, examined and filed.

In December of 1987, the State Grand Jury issued the following Indictment: (See exhibit "C").

After the Indictment, our material that had been obtained prior to presentation to the Grand Jury and was not testimony obtained by the Grand Jury, was given to the Inspector General's Office and P.W.B.A..

During July and August, 1988, hearings were held in Santa Fe, New Mexico on a change of venue from Eddy County, New Mexico. At that time, all pension fund counts were dismissed by the State Trial Court based on the court's ruling that there was no State jurisdiction.

A Notice of Appeal in this matter was filed by the New Mexico Attorney General on September 12, 1988. This stayed the proceedings at the State level.

In September 1988, all Grand Jury evidence was made available to the Department of Labor by me. At this time, our office had been working the case independently for nine months. As ordered by Thomas A. Rutledge, District Attorney, I remained assigned to the Lundberg case until completion of the federal prosecution.

The State of New Mexico withdrew the Appeal of the dismissal of the pension fund counts when the federal Indictment was handed down in 1989. The remaining State counts were dismissed upon conviction of the Defendants in the United States District Court in 1990.

Alternative enforcement strategies that were considered included a referral of the case to local law enforcement, primarily the Carlsbad Police Department as well as other state agencies. It was determined after viewing the available facts that there were no white collar investigators available for lengthy assignment to a case of this complexity and magnitude.

This case had to be investigated by criminal investigators who could conduct the investigation in such a manner that upon completion it could be effectively presented by prosecution, either state or federal.

It was further determined that the coordination between the state and federal agencies would be critical for a successful completion of the case. The cooperation provided by the Inspector General's Office of the Department of Labor was both professional and total.

I would respectively submit to the Subcommittee that these types of investigations in my experience of 19 years in criminal cases require trained, experienced criminal investigators of the caliber of Steve Crowe who was provided by the Office of the Inspector General, Department of Labor.

EXHIBIT
"A"

FIFTH JUDICIAL DISTRICT COURT
COUNTY OF EDDY
STATE OF NEW MEXICO

IN THE MATTER OF:

CONVENING A GRAND JURY

NO. CV 87-01-GJ

CLERK'S CERTIFICATE

STATE OF NEW MEXICO)
: **ss.**
COUNTY OF EDDY)

I, ELEANOR JARNAGIN, Clerk of the District Court of the Fifth Judicial District within the County of Eddy, State of New Mexico, do hereby certify that the attached is a full, true and correct copy of the original

PETITION FOR GRAND JURY - Filed and Docketed August 24, 1987.

ORDER CONVENING GRAND JURY - Filed and Dockted September 22, 1987.

in the above-entitled cause, all as shown from the files and records of said Office.

IN WITNESS WHEREOF, I have hereunto set my hand and the seal of said Court this 22nd **day of** May**, 19** 90 **.**

ELEANOR JARNAGIN
CLERK OF THE DISTRICT COURT

[S E A L]

Joyce A. Hatfield
DEPUTY COURT CLERK

FIFTH JUDICIAL DISTRICT
STATE OF NEW MEXICO
COUNTY OF EDDY
FILED SEP 22 1987
1:57 pm
ELEANOR JARNAGIN
Clerk of the District Court

FIFTH JUDICIAL DISTRICT COURT
COUNTY OF EDDY
STATE OF NEW MEXICO

IN THE MATTER OF:

CONVENING A GRAND JURY — No. CV-87-01-S

ORDER CONVENING GRAND JURY

THE COURT, being fully advised in the premises and deeming it necessary, finds that a Grand Jury should be convened for the purposes of considering allegations of unlawful conduct on the part of Lundberg Industries Ltd., its officers, directors, agents, servants, consultants, or employees, individuals or corporations doing business with Lundberg Industries, Ltd. and for the purpose of considering other criminal cases which may be presented to it.

IT IS THEREFORE ORDERED that a Grand Jury composed of registered voters of Eddy County, New Mexico, be convened at 9:00 A.M. on the 1st day of October, 1987 in the Courtroom #1 of the Eddy County Courthouse to consider allegations of unlawful conduct on the part of Lundberg Industries Ltd., its officers, directors, agents, servants, consultants or employees, or individuals or corporations doing business with Lundberg Industries, Ltd. and for the purpose of considering other criminal cases which may be presented to it.

IT IS FURTHER ORDERED that the names of twelve (12) Grand Jurors and three (3) alternates be selected from the list of said persons, and that twelve (12) Grand Jurors and three (3) alternates be qualified in open court prior to the convening of the Grand Jury on the 1st day of October, 1987.

JAMES L. SHULER
District Judge

EXHIBIT
"B"

FIFTH
EDDY C
'87 MAR 24 A10:36
CLERK

D

PETITION FOR GRAND JURY

We, the undersigned registered voters of Eddy County, New Mexico hereby petition the District Judge to convene a Grand Jury to investigate whether or not there was;

(1) Misappropriation, misuse, or theft of pension funds, insurance funds, or workmen's compensation funds at Lundberg Industries Ltd.

(2) Fraudulent misrepresentation concerning benefit plans or funds at Lundberg Industries Ltd.

(3) Actions which may come under the State Anti-Racketeering Statutes in connection with pension plans and funds, insurance plans and funds or workmen's compensation plans and funds of Lundberg Industries Ltd.

(4) Violations of the State insurance or workmen's compensation statutes.

CV87-1-S

SIGNATURE	NAME PRINTED AS REGISTERED TO VOTE	ADDRESS
		Carlsbad, N.M
1 Charles A. Brown	Charles A. Brown	1807 Palomas
2 Clyde E Rodgers	CLYDE E. RODGERS	205 ELMDALE
3. Jack R. Mabors	JACK D. MABERS	815 VALVERDE
4 Denise Mabors	DENISE MABERS	815 VALVERDE
5 Ronald L. Tackitt	Ronald L. Tackitt	403 N 2nd.
6 Monico J. Aguilera	MONICO J. AGUILERA	2701 CARVER ST.
7 W. W. Sutton	WOODROW W. SUTTON	713 WINGEDFOOT DR.
8 W.E. Dillard	W.E. DILLARD	1029 N. main
9 A.W. Weems	AW Weems	614 N ASh
10 Duane Barnett	L.H. DUANE BARNETT	502 S. MESA
11 Louis B. Brown	LOUIS B BROWN	2210 Mt. View
12 Frank Nunley	Frank Nunley	1912 MANZANA
13 Donvell D George	Donvell D George	2201 W. Texas ST
14 B. J. Bennett	B.J. Bennett	1411 N. C.C.
15 Donald G. London	DONALD LONDON	3510 W. LEA
16 T. L. London	T.L. LONDON	2001 Georgia
17 B. S. Pomroy	B.S. Pomroy	2608 WYO. ST
18 L M Whitaker	Louis M. Whitaker	1200 N. Shore Dr.

COPY

FIFTH JUDICIAL [illegible]
EDDY COUNTY [illegible]
FILED

'87 DEC 21 P2:59

CLERK OF THE DISTRICT COURT

No. CR-87-232 S

IN THE DISTRICT COURT OF EDDY COUNTY
STATE OF NEW MEXICO

STATE OF NEW MEXICO)
)
Plaintiff,)
)
vs.)
)
THOMAS LUNDBERG, JOHN SANDERS,)
CLARENCE D. DONALDSON, KENNETH)
LUNDBERG, LOIS LUNDBERG, GREG)
LUNDBERG, SAMUEL LONGO, DAVID)
BOATRIGHT, and JOHN EGAR,)
Defendants.)

GRAND JURY INDICTMENT

THE GRAND JURY CHARGES:

COUNT I

That during the period of November, 1985 through June, 1987, the Defendants, Thomas Lundberg, John Sanders, Clarence D. Donaldson, Kenneth Lundberg, Lois Lundberg, Greg Lundberg, Samuel Longo, David Boatright and John Egar, committed the crime of Conspiracy to Commit Racketeering in that they did, by words or acts with intent to commit Racketeering, agree or conspired together to conduct or participate, directly or indirectly, in the conduct of Lundberg Industries, Ltd.'s, an enterprise, affairs by engaging in a pattern of racketeering activity. That all or some of the acts occurred in Eddy County, New Mexico, and are contrary to Section 30-42-4D, N.M.S.A., 1978 Compilation as amended, a Third Degree Felony.

COUNT II

That on or about December 20, 1985, the Defendants, Thomas Lundberg, John Sanders, and Kenneth Lundberg, committed the Crime of Attempted Fraud in Excess of $20,000 by attempting to intentionally misappropriate or take something of value in excess of $20,000 which belonged to Carlsbad National Bank.

The Defendants acted as principals or accessories each aiding or abetting the other or another and by means of fraudulent conduct, practices or representations which were intended to be relied on by Carlsbad National Bank attempted to obtain $3,000,000 from Carlsbad National Bank. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Sections 30-28-1 and 30-16-6, N.M.S.A., 1978 Compilation. Attempted Fraud in Excess of $20,000 is a Third Degree Felony.

EXHIBIT
"C"

COUNT III

That on or about December 20, 1985, the Defendants, Thomas Lundberg, John Sanders, and Kenneth Lundberg, by words or acts with intent to commit Fraud, agreed or conspired together (and/or with others) to Commit Fraud in Excess of $20,000 by making material misrepresentations or omissions directly or indirectly to Carlsbad National Bank in order to fraudulently induce Carlsbad National Bank to loan to Lundberg Industries, Ltd., $3,000 000. All or some of the acts occurred in Eddy County, New Mexico. This Conspiracy was a Third Degree Felony in violation of Sections 30-28-2 and 30-16-6, N.M.S.A., 1978 Compilation.

COUNT IV

On or about December 31, 1985, Defendants, Thomas Lundberg, John Sanders, Kenneth Lundberg and Clarence D. Donaldson, committed the Crime of Fraud in Excess of $20,000 by intentionally misappropriating or taking something of value in excess of $20,000 which belonged to Ideal Basics, Inc. The Defendants acted as principals or accessories each aiding or abetting the other or another and by means of fraudulent conduct, practices or representations, which were relied on by Ideal Basics, Inc., obtained ownership or control of the assets of Potash Corporation of America including that company's Carlsbad potash mining operations, mining equipment, fixtures, potash reserves or potash inventories worth more than $20,000. That all or some of the acts occurred in Eddy County, New Mexico, and are contrary to Section 30-16-6, N.M.S.A., 1978 as amended. Fraud in Excess of $20,000 is a Second Degree Felony.

COUNT V

That on or about December 31,1985, the Defendants, Thomas Lundberg, John Sanders, Kenneth Lundberg and Clarence D. Donaldson, by words or acts with intent to commit Fraud, agreed or conspired together and with others to commit Fraud in Excess of $20,000 by making material misrepresentations or omissions directly or indirectly to Ideal Basics, Inc., in order to fraudulently induce Ideal Basics, Inc., to sell to Lundberg Industries, Ltd., the New Mexico and Texas Potash Mining Operations of Potash Corporation of America. That all or some of the acts occurred in Eddy County, New Mexico and that this Conspiracy was a Third Degree Felony in violation of Sections 30-28-2 and 30-16-6, N.M.S.A., 1978 as amended.

COUNT VI

That during the period of January 12-15, 1986, Defendants, Thomas Lundberg, John Sanders, Clarence D. Donaldson, David J.

Boatright, Kenneth Lundberg, Lois Lundberg and Greg Lundberg, committed the Crime of Improper Sale of Encumbered Property. The Defendants acted as principals or accessories, each aiding or abetting the other or another and intentionally sold or caused to be sold property located in Eddy County, New Mexico which was subject to a prior lien. Specifically, the Defendants sold or caused to be sold to Joseph Wall all of the mining equipment of the Potash Corporation of America, Carlsbad Potash Mine, which Lundberg Industries, Ltd., had purchased from Ideal Basics, Inc. on December 31, 1985, subject to a lien in favor of Ideal Basics, Inc. That all or some of the acts occurred in Eddy County, New Mexico, and are contrary to Section 30-16-18, N.M.S.A., 1978 as amended. Improper Sale of Encumbered Property in Excess of $2,500 is a Third Degree Felony.

COUNT VII

That during the period January 12-15, 1986, Defendants, Thomas Lundberg, John Sanders, Clarence D. Donaldson, David Boatright, Kenneth Lundberg, Lois Lundberg and Greg Lundberg, as principals or accessories, each aiding or abetting the other or another, committed the Crime of Embezzlement Over $2500 by converting to their own use something of value with which they had been entrusted with fraudulent intent to deprive the owner thereof, namely, money in an amount over $2500 belonging to the past or present employees of the Potash Company of America, Carlsbad Potash Mining Operation, as beneficiaries of the Carlsbad Employees' Pension Fund.

The Defendants caused Lundberg Industries, Ltd., to enter into a sale and lease back agreement with Joseph Wall under which Wall purchased the mining equipment of the Potash Corporation of America, Carlsbad Potash Mining Operation, for the sum of $28,000,000. Under that agreement, Wall paid a $2,000,000 cash down payment and gave Lundberg Industries, Ltd., a note for $26,000,000. The note was non-recourse, payable only out of the proceeds of lease payments which Lundberg Industries, Ltd., promised to pay Wall for the use of the mining equipment which was never moved from its site in Carlsbad. The $2,000,000 down payment was embezzled by the Defendants from the Carlsbad Employees' Pension Fund which had been transferred to Lundberg Industries, Ltd., by Ideal Basics, Inc., on December 31, 1985, with funds being transferred on or about January 7, 1986. That Pension Fund was held in trust by Lundberg Industries, Ltd., for the present and former employees of the Potash Corporation of America, Carlsbad Potash Mining Operation. Defendants Thomas Lundberg and John Sanders were the trustees of the Pension Fund. On or about January 15, 1986, the Defendants caused the Pension Fund to loan $2,000,000 to Joseph Wall, secured by the Carlsbad Potash Mine Equipment which was previously encumbered and therefore worthless as collateral. The equipment was intentionally overvalued at $28,000,000 for purposes of this loan transaction.

The $2,000,000 loaned to Joseph Wall from the Pension Fund was immediately paid to the Defendants for Lundberg Industries, Ltd., as the down payment for Wall's purchase of the mining equipment. Of this $2,000,000, more than $20,000 was taken by the Defendants for their own uses including, but not limited to, an excess of $1,000,000 taken by John Sanders and $235,000 taken by Thomas Lundberg. That all or some of the acts occurred in Eddy County, New Mexico, and are contrary to Section 30-16-8, N.M.S.A., 1978 Compilation. Embezzlement of more than $2500 is a Third Degree Felony.

COUNT VIII

That during the period of January 12-15, 1986, the Defendants, Thomas Lundberg, John Sanders, Clarence D. Donaldson, David Boatright, Kenneth Lundberg, Lois Lundberg and Greg Lundberg, by words or acts with intent to commit Embezzlement over $2500 agreed or conspired together and with others to commit Embezzlement over $2500 by converting to their own use money in excess of $2500 with which they had been entrusted by the past or present employees of the Potash Corporation of America, Carlsbad Potash Mining Operation, as beneficiaries of the Carlsbad Employees' Pension Fund with intent to fraudulently deprive those employees of the money taken. This embezzlement was intended to be committed through sham loans of at least $2,000,000 to Joseph Wall, secured by mining equipment which was to be intentionally overvalued and which was already encumbered. That all or some of the acts occurred in Eddy County, New Mexico and that this Conspiracy was in violation of Sections 30-28-2 and 30-16-8, N.M.S.A., 1978 as amended, a Fourth Degree Felony.

COUNT IX

That between December 31, 1985 and December 31, 1986, the Defendants, Thomas Lundberg, John Sanders, Kenneth Lundberg, Lois Lundberg and Greg Lundberg, as principals or accessories, each aiding or abetting the other or another, committed the Crime of Embezzlement over $2500 by converting to their own use something of value over $2500 with which they had been entrusted with fraudulent intent to deprive the owners thereof, namely United States Currency in excess of $2500 which belonged to Ideal Basics, Inc.

On December 31, 1985, Defendant Thomas Lundberg acquired all the assets of the Potash Corporation of America, Carlsbad Potash Mining Operation, from Ideal Basics, Inc. As part of that transaction, Thomas Lundberg and his Corporation, Lundberg Industries, Ltd., obtained 161,000 tons of potash inventory. By agreement with Ideal Basics, Inc., Thomas Lundberg was to cause all of that inventory to be sold and to pay 75% of the proceeds of those sales to Ideal Basics, Inc., on December 31, 1986. That between January, 1986 and November, 1986, the Defendants caused the potash inventory to be sold. Seventy-five percent of the money received from those sales (which amounted to approximately $6,400,000) was held in trust for Ideal Basics, Inc., to be paid on December 31, 1986. Instead, the Defendants converted all the proceeds of the potash inventory sales to their own use and paid none of it to Ideal Basics, Inc. That all or some of these acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-8, N.M.S.A., 1978 as amended. Embezzlement over $2500 is a Third Degree Felony.

COUNT X

That during the period of December 31, 1985 through December 31, 1986, the Defendants, Thomas Lundberg, Kenneth Lundberg, Lois Lundberg, Greg Lundberg and John Sanders, by words or acts, with intent to commit Embezzlement over $2500, agreed or conspired together and with others to commit Embezzlement over $2500 by converting to their own use, money in excess of $2500 with which they had been entrusted by Ideal Basics, Inc., to-wit: 161,000 tons of potash inventory and the proceeds derived from the sale thereof. All or some of the acts occurred in Eddy County, New Mexico. This Conspiracy was in violation of Sections 30-28-2 and 30-16-8, N.M.S.A., 1978 Compilation and is a Fourth Degree Felony.

COUNT XI

That during the period of December 15, 1986 through January 15, 1987, Thomas Lundberg, Lois Lundberg, Clarence D. Donaldson, David Boatright, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Embezzlement by converting to their own use something of value over $2500 with which they had been entrusted, with fraudulent intent to deprive the owners thereof, namely money, in excess of $2500, belonging to the past and present employees of the Potash Corporation of America, Carlsbad Potash Mining Operation, as beneficiaries of the Carlsbad Employees' Pension Fund.

The Defendants caused the Carlsbad Employees' Pension Fund to make two loans totaling approximately $1,550,000 to 127, Inc., in exchange for collateral they knew to be previously encumbered by a prior mortgage and converted the proceeds of those loans to their own use. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-8, N.M.S.A., 1978 as amended. Embezzlement over $2500 is a Third Degree Felony.

COUNT XII

That during the period of December 15, 1986 through January 15, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Clarence D. Donaldson, David Boatright, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg and Greg Lundberg, by words or acts with the intent to commit Embezzlement over $2500 agreed or conspired together and with others to commit Embezzlement over $2500 by converting to their own use with intent to defraud the owners thereof, funds over $2500 with which they had been entrusted by the past or present employees of the Potash Corporation of America, Carlsbad Potash Mining Operation, as beneficiaries of the Carlsbad Employees' Pension Fund. This Embezzlement was to be carried out through loans made out of the Pension Fund of approximately $1,550,000 to 127, Inc., to be secured by collateral the Defendants knew to be already encumbered. That all or some of these acts occurred in Eddy County and that this Conspiracy was a Fourth Degree Felony contrary to Sections 30-28-2 and 30-16-8, N.M.S.A., 1978 Compilation, as amended.

COUNT XIII

That on or about February 25, 1987, Defendants, Thomas Lundberg, John Sanders, Clarence D. Donaldson, David Boatright, Kenneth Lundberg, Lois Lundberg, and Greg Lundberg, as principals or accessories each aiding or abetting the other or another, committed the Crime of Embezzlement Over $2500 by converting to their own use something of value with which they had been entrusted, with fraudulent intent to deprive the owner thereof, namely money in an amount over $2500 belonging to the past or present employees of the Potash Corporation of America, Carlsbad Potash Mining Operation, as beneficiaries of the Carlsbad Employees' Pension Fund. The Defendants caused the Carlsbad Employees' Pension Fund to loan to Joseph Wall the sum of $572,000; which sum was added to an already outstanding note by Wall to the Pension Fund and which was secured by already encumbered and grossly overvalued security, namely the mining equipment of the Potash Corporation of America, Carlsbad Potash Mining Operation. The $572,000 loan to Joseph Wall by the Pension Fund was given to the Defendants who converted it to their own use. That all or some of the acts occurred in Eddy County, New Mexico, and are contrary to Section 30-16-8, N.M.S.A., 1978 Compilation. Embezzlement of More Than $2500 is a Third Degree Felony.

COUNT XIV

That on or about February 25, 1987, the Defendants, Thomas Lundberg, John Sanders, Clarence D. Donaldson, David Boatright, Lois Lundberg, Kenneth Lundberg, and Greg Lundberg, by words or acts, with intent to commit Embezzlement over $2500, agreed or conspired together and with others to commit Embezzlement over $2500 by converting to their own use, money in excess of $2500, with which they had been entrusted by past or present employees of the Potash Corporation of America, Carlsbad Potash Mining Operation, as beneficiaries of the Carlsbad Employees' Pension Fund. All or some of the acts occurred in Eddy County, New Mexico. This Conspiracy was in violation of Sections 30-28-2 and 30-16-8, N.M.S.A., 1978 Compilation and is a Fourth Degree Felony.

COUNT XV

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $20,000 by intentionally misappropriating or taking something of value in excess of $20,000 which belonged to Westport Steel. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Westport Steel took something of value over $20,000, namely products or supplies worth $39,747.93 which were provided to Lundberg Industries, Ltd., on credit by Westport Steel. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $20,000 is a Second Degree Felony.

COUNT XVI

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $2500 by intentionally misappropriating or taking something of value in excess of $2500 which belonged to Lehman Paint. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Lehman Paint took something of value over $2500, namely products or supplies worth $9,540.90 which were provided to Lundberg Industries, Ltd., on credit by Lehman Paint. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $2500 is a Third Degree Felony.

COUNT XVII

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $2500 by intentionally misappropriating or taking something of value in excess of $2500 which belonged to Martin Pallet. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Martin Pallet took something of value over $2500, namely products or supplies worth $12,249.92 which were provided to Lundberg Industries, Ltd., on credit by Martin Pallet. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $2500 is a Third Degree Felony.

COUNT XVIII

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $20,000 by intentionally misappropriating or taking something of value in excess of $20,000 which belonged to Union Industrial. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Union Industrial took something of value over $20,000, namely products or supplies worth $62,691.75 which were provided to Lundberg Industries, Ltd., on credit by Union Industrial. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $20,000 is a Second Degree Felony.

COUNT XIX

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $2500 by intentionally misappropriating or taking something of value in excess of $2500 which belonged to Mining Service & Supply. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Mining Service & Supply took something of value over $2500, namely products or supplies worth $10,860.89 which were provided to Lundberg Industries, Ltd., on credit by Mining Service & Supply. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $2500 is a Third Degree Felony.

COUNT XX

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $20,000 by intentionally misappropriating or taking something of value in excess of $20,000 which belonged to Electric Supply. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Electric Supply took something of value over $20,000, namely products or supplies worth $36,594.76 which were provided to Lundberg Industries, Ltd., on credit by Electric Supply. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over ~~«amount»~~ $20,000 is a ~~«degree»~~ Second Degree Felony.

COUNT XXI

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $20,000 by intentionally misappropriating or taking something of value in excess of $20,000 which belonged to Industrial Electric Service. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Industrial Electric Service took something of value over $20,000, namely products or supplies worth $55,833.92 which were provided to Lundberg Industries, Ltd., on credit by Industrial Electic Service. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $20,000 is a Second Degree Felony.

COUNT XXII

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $20,000 by intentionally misappropriating or taking something of value in excess of $20,000 which belonged to Garrett Supply Corporation. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Garrett Supply Corporation took something of value over $20,000, namely products or supplies worth $25,178.10 which were provided to Lundberg Industries, Ltd., on credit by Garrett Supply Corporation. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $20,000 is a Second Degree Felony.

COUNT XXIII

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $2500 by intentionally misappropriating or taking something of value in excess of $2500 which belonged to Fincher Oil Company. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Fincher Oil Company took something of value over $2500, namely products or supplies worth $15,963.15 which were provided to Lundberg Industries, Ltd., on credit by Fincher Oil Company. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $2500 is a Third Degree Felony.

COUNT XXIV

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $20,000 by intentionally misappropriating or taking something of value in excess of $20,000 which belonged to Southwestern Public Service. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Southwestern Public Service took something of value over $20,000, namely products or supplies worth $452,793.23 which were provided to Lundberg Industries, Ltd., on credit by Southwestern Public Service. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $20,000 is a Second Degree Felony.

COUNT XXV

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $2500 by intentionally misappropriating or taking something of value in excess of $2500 which belonged to T & S Auto. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by T & S Auto took something of value over $2500, namely products or supplies worth $13,226.97 which were provided to Lundberg Industries, Ltd., on credit by T & S Auto. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $2500 is a Third Degree Felony.

COUNT XXVI

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $20,000 by intentionally misappropriating or taking something of value in excess of $20,000 which belonged to Mine Supply. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Mine Supply took something of value over $20,000, namely products or supplies worth $61,777.70 which were provided to Lundberg Industries, Ltd., on credit by Mine Supply. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $20,000 is a Second Degree Felony.

COUNT XXVII

That during the period of April, 1987 and June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Samuel Longo, John Egar, John Sanders, Kenneth Lundberg, and Greg Lundberg committed the Crime of Fraud over $2500 by intentionally misappropriating or taking something of value in excess of $2500 which belonged to Forrest Tire. The Defendants acted as principals or accessories, each aiding or abetting the other or another, and by means of fraudulent conduct, practices or representations which were relied on by Forrest Tire took something of value over $2500, namely products or supplies worth $8,035.98 which were provided to Lundberg Industries, Ltd., on credit by Forrest Tire. The fraudulent practices or representations included, but were not limited to misrepresentations or material omissions as to the financial status and prospects of Lundberg Industries, Ltd. That all or some of the acts occurred in Eddy County, New Mexico and are contrary to Section 30-16-6, N.M.S.A., 1978 Compilation, as amended. Fraud over $2500 is a Third Degree Felony.

COUNT XXVIII

That during the period of April, 1987 through June, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Kenneth Lundgerg, Greg Lundberg, John Sanders, Sam Longo and John Egar, with intent to commit fraud over $20,000 agreed or conspired together and with others to commit fraud over $20,000 by making material misrepresentations or omissions directly or indirectly to vendors of products and services to Lundberg Industries, Ltd., in order to fraudulently induce such vendors to extend credit to Lundberg Industries, Ltd. by concealing the true financial status and prospects of Lundberg Industries, Ltd. That all or some of these acts occurred in Eddy County and that this Conspiracy was a Third Degree Felony contrary to Sections 30-28-2 and 30-16-6, N.M.S.A., 1978 as amended.

COUNT XXIX

That during the period of January 1, 1986 through June 17, 1987, the Defendants, Thomas Lundberg, Lois Lundberg, Kenneth Lundberg, Greg Lundberg, John Sanders, Clarence D. Donaldson, David Boatright, Samuel Longo and John Egar, intentionally committed the crime of Racketeering while associated with an enterprise, namely Lundberg Industries, Ltd., a New Mexico corporation and its associated business entities. The Defendants intentionally conducted or participated in the conduct of the affairs of the enterprise by engaging in two or more incidents of racketeering activity comprising a pattern of racketeering activity. The incidents of racketeering activity consisted of two or more of the felonious acts of fraud or embezzlement as more fully described and charged in Counts IV, VII, IX, XI, XII, and XV through XXVII of this Indictment and incorporated herein by reference as incidents of racketeering. The felony of fraud is a racketeering offense in the New Mexico Racketeering Act as described in Section 30-42-3A(6), N.M.S.A., 1978 as amended. The felony of embezzlement is a racketeering offense in the New Mexico Racketeering Act as described in Section 30-42-3A(7), N.M.S.A., 1978 as amended. That all or some of the acts occurred in Eddy County, New Mexico and that the crime of Racketeering is a Second Degree Felony contrary to Section 30-42-4, N.M.S.A., 1978 as amended.

The names of the witnesses upon whose testimony this Indictment is based are as follows:

Tom Donaldson
Glenn Connie Day
Harold Younger
Dallas Martin
David Nelson
Jerry Jones
Mary Ellen Scanlan
Cecil B. Arnold
Billy Garrett
Donald Bigham
Jack Skinner
Robert Forrest
Ellen Jo Willoughby
David Elmquist
Tom Martin
Billy Roten
David Henderson
Jerry Porter
Jim Renfro
Paavo Tuominen
Deborah Watson
Joe Hanttula
William A. Beidel
Neoma Wright
Sondra O'Neal
Alan Tedford
Joe Wall
Steve Berrey
Mike Chitty
Dan Redfern
Denis DeLuche

I hereby certify that the foregoing instrument is a True Bill.

s/
JOHN A. THOMASON, Foreman

DATE: 21-Dec-87

APPROVED:

s/ TR
THOMAS A. RUTLEDGE
District Attorney

s/ TR for
HAL STRATTON by. FRED C. SMITH
Attorney General

STATEMENT OF STEVENS T. CROWE, SENIOR SPECIAL AGENT, OFFICE OF THE INSPECTOR GENERAL, OFFICE OF INVESTIGATIONS, U.S. DEPARTMENT OF LABOR

Mr. Crowe. Mr. Chairman and members, thank you for your invitation to testify today.

The inspector general's office, as Mr. DeLuche has already testified, we initiated the investigation in August of 1987 at the specific request of William DeLuche, the U.S. attorney for the district of New Mexico.

Mr. Lutz received a number of complaints from retirees, pensioners, and had also received congressional interest from the part of the House Members from New Mexico to look into this situation.

There were specific allegations of fraud involving the pension plan, as well as other issues involving fraud of local vendors. There were indications in the case from its initiation there may have been a bust out, a bankruptcy bust out in which the, what later became the defendants, intentionally bought the company to loot it.

When we first looked at the case, it's a large case, and it later became—it's simple and yet complex, but we knew right from the start we were looking at a case in which the financial loss could be in excess of $9 million. And we had 900 potential victims in that retirement plan.

Understanding that the case had other aspects that do not fall into the jurisdiction of the Department of Labor, we immediately began to coordinate with the State investigators at the attorney general's office level, and with the New Mexico district attorney's office in Carlsbad, N. Mex.

We formed alliances, cooperative agreements, and began exchanging information right from the start. This particular case, our initial work on it involved tracing cash. We knew how much money had come into the hands of Mr. Lundberg and John Sanders through financial records of Ideal Basic.

We began to trace those funds. What we ended up with after subpoenaing various records and acquiring other financial records through other means, there were over 100 financial accounts, both domestic and foreign, of Lundberg Industries, Ltd.

We followed certain funds through those accounts. We then followed the funds through the personal accounts of some of the subjects, their associates and other business ventures that these individuals ran.

We ran into some small problems in doing that financial analysis because when Mr. Lundberg and Mr. Sanders actually got their hands on some of the pension money, which was January 13 and 14 of 1986, they put the money in the Midlothian National Bank in Midlothian, Tex. It's a small rural bank which at that time two of the members of the board of directors were Mr. Lundberg and Mr. Sanders.

We did have some problems with the records at that bank in chasing the money down because the microfishe was unreadable in many instances. We were then later able to solve that with the cooperation of the defendants that pled and during negotiation.

While we were completing our financial analysis, as Mr. DeLuche testified, the State brought its charges. We continued our case as the State case went through the court. When the problem developed over jurisdiction pension matters as to whether the State of New Mexico had jurisdiction to prosecute—embezzlement of funds regulated by a Federal statute—when that problem came up and those charges were dismissed, our cooperation increased.

We got to the point that we were working on a daily basis together on this case. We merged our records. It does not make sense to have three difference, complete sets of financial records, three different sets of interviews, notes, and three different places in which you have evidence stored, cataloged and analyzed.

We merged our records together and began to work right under the direct supervision of two assistant U.S. attorneys who were very experienced in white collar crime in putting the case together for prosecution.

All the parties got together and developed a proposed indictment. The indictment was presented to a Federal grand jury in Albuquerque, N. Mex.

In March of 1989, five defendants were indicated on charges of conspiracy to embezzle pension funds, the actual embezzlement of pension funds and mail fraud.

The case had a large amount of disclosure involved in it. The counsels for the defendants filed numerous motions regarding the validity of the charges, motions for—they actually wanted to analyze the same financial records we already had.

We treated the case as an open-file case. The defendants were given extensive amounts of disclosure information. That is part of the reason that although we had an indictment in Spring of 1989, it took us all the way until the Winter of 1989 to go to trial.

In January 1990, we put on—the trial was held in Albuquerque, N. Mex. Mr. DeLuche and I and other members of the investigative groups delivered subpoenas and prepared 52 witness and thousands of financial documentation for presentation at trial.

We got those individuals together with the prosecutors, presented the evidence of the trial, and 12 citizens in New Mexico agreed with the charges and found the defendants guilty of conspiracy to embezzle pension funds and actual embezzlement of the pension funds.

The trustees of those pension funds, Tom Lundberg and John Sanders, are currently in prison where they belong.

I would be happy to answer any questions that the committee may have at any time.

[The prepared statement follows:]

STATEMENT OF STEVENS T. CROWE
SENIOR SPECIAL AGENT
OFFICE OF THE INSPECTOR GENERAL
OFFICE OF INVESTIGATIONS
U.S. DEPARTMENT OF LABOR
BEFORE THE COMMITTEE ON WAYS AND MEANS
OF THE
SUBCOMMITTEE ON OVERSIGHT
U.S. HOUSE OF REPRESENTATIVES
June 12, 1990

Mr. Chairman and Members of the Subcommittee:

Thank you for your invitation to testify today. You have asked me to present information regarding the investigation of Lundberg Industries Limited. It is with sincere appreciation of your interest and concern that I am providing my testimony.

The Inspector General's Office of Investigations (OI) first initiated an investigation into the pension plans of Lundberg Industries Ltd., a New Mexico Corporation, in August 1987 at the specific request of William Lutz, the United States Attorney for the District of New Mexico. Mr. Lutz requested an investigation in response to allegations he had received from the pensioners of Lundberg Industries Ltd., and others.

An official OI investigation was opened on September 1, 1987. This investigation was initiated as a priority criminal case with over 900 participant victims allegedly suffering a financial loss in excess of $9 million.

OI initially sought cooperation from the Dallas office of the Pension and Welfare Benefits Administration (PWBA). Unfortunately, PWBA refused to provide any cooperation. We knew the case had significant press and congressional interest in the State of New Mexico, and that other investigative authorities had a genuine interest in the subjects of this investigation. There existed significant criminal allegations involving the company which did not involve the company's pension plans (sale of encumbered property, vendor fraud, bankruptcy fraud, etc.). Coordinated efforts and agreements were sought and formed among OI, the local district attorneys office, and the New Mexico Attorney General.

No alternative enforcement strategies were considered in this case. Criminal prosecution was the only strategy employed. OI pursued the investigation as a scheme by corporate officers to loot the pension plans and assets of Lundberg Industries Ltd. This was accomplished through sham loans on mining equipment of dubious value and ownership, and fraudulent real estate transactions. Significant and voluminous financial data concerning the company's pension plans was acquired and OI coordinated the use of OIG audit resources to more efficiently and expeditiously complete a detailed financial analysis. During this process over 100 bank accounts were reviewed and analyzed at the direction and supervision of OI Special Agents. These accounts included the domestic and foreign corporate accounts of Lundberg Industries Ltd. (i.e., receipts, payroll, insurance, investment, etc.). Included in the financial analysis were the personal accounts of the subjects and various other corporations and businesses operated by the subjects and their associates. The financial work was complicated by the fact that several of the more important accounts were located in financial institutions which were partially controlled and managed by two of the subjects of the investigation.

While the financial investigation was being completed, the State of New Mexico filed numerous charges in December 1987 against nine defendants related to Lundberg Industries Ltd. The majority of these charges were not related to the company's pension plans, but they did include charges of embezzlement of pension funds and conspiracy to embezzle pension funds. Attorneys for the defendants filed pretrial motions and basically argued their clients could not be charged in state court for embezzling funds subject to federal regulation. In July and August 1988, a New Mexico State District Judge heard arguments on this subject and the state charges related to pension funds were subsequently dismissed.

Following the dismissal of the state charges, OI continued its financial investigation in consultation with two Assistant United States Attorneys in Albuquerque, New Mexico who specialize in white collar crime. OI Senior Special Agents and local investigative authorities began to work together on a daily basis. The coordination of efforts included the consolidation and merging of thousands of files, records, interviews, evidence and notes. The only significant records not merged were those subject to grand jury secrecy, guidelines and safeguards. Prosecutive meetings and strategy sessions were held with the United States Attorneys Office on a continuing basis.

A Prosecution Report detailing the findings of the investigation was prepared and submitted to the United States Attorneys Office. The prosecution report contained the findings of the combined investigative work done on the case. The report provided not only the details of the offenses, but also a detailed list of the exhibits and proposed witnesses, along with a summary of their expected testimony.

The investigation disclosed that beginning on or about October 1, 1985, Thomas D. Lundberg, a North Texas businessman and land developer, and John Sanders, an attorney, conspired to devise a scheme to fraudulently obtain and convert to their own use, the assets of the Potash Company of America. These assets included over twenty million dollars in three employee pension plans subject to the Employee Retirement Income Security Act of 1974 (ERISA). The investigation disclosed that in carrying out their scheme they were joined and aided and abetted by others, including Clarence David Donaldson, a Dallas Insurance Agent and business partner of John Sanders; David Boatright, an actuary in Nashville, Tennessee; Samuel Longo a self professed financial expert and convicted felon; and Joseph Wall, a financial planner from Nashville, Tennessee.

As part of the scheme to defraud, Lundberg, Sanders, Donaldson, Boatright and Wall participated in an embezzlement of over $2.5 million dollars from the Lundberg Industries Ltd. Hourly Employees Pension Plan through a sham loan, purchase and lease back involving mining equipment, which had an existing mortgage on it. Lundberg, Longo, Boatright,and Donaldson also participated in an embezzlement of over $1,550,000 in pension funds through two sham loans on rural property owned by Lundberg. Furthermore, Lundberg, Sanders, Boatright and Donaldson participated in an embezzlement of $1,503,901 in pension funds through the sale of corporate stock to the company's pension plans at inflated and unrealistic prices. Additionally, Lundberg, Sanders, Boatright, and Donaldson participated in a scheme to unlawfully terminate the company's pension plans and obtain $3,649,637 in funds without complying with ERISA requirements.

A proposed indictment was prepared for presentation to a federal grand jury. The structuring and preparation of this indictment was an involved process due to the complex nature of the case. The proposed indictment was the product of the efforts of OI, the Assistant U.S. Attorneys, New Mexico State Attorney General's Office, and the District Attorney for the 11th Judicial District of New Mexico.

In March 1989, a thirteen count indictment related to the Lundberg Industries Ltd., investigation was presented to a federal grand jury in Albuquerque, New Mexico, for their consideration. The grand jury returned a true bill charging five defendants with conspiracy, embezzlement, and mail fraud. Following the return of the indictment we assisted the prosecutors in preparing for pretrial motions.

During 1989 this case worked its way through the court system and various pretrial motions and hearings were held. As a result of negotiations between the prosecution and counsel for the defendants plea agreements were reached between the government and defendants Longo, Boatright, Donaldson, and Wall. Lengthy and detailed debriefings of these defendants were conducted by Denis DeLuche and me. Trial for defendants Lundberg and Sanders was scheduled for January 1990 in Albuquerque, New Mexico.

Preparing for the scheduled trial required enormous efforts on the parts of the prosecutors and investigators assigned to this investigation. Virtually thousands of pages of documents were prepared for court presentation as exhibits. In addition, over fifty (50) witnesses were served with subpoenas, reinterviewed and prepared for trial. Two senior agents with OI and the chief investigator for the Eddy County District Attorney's Office worked nonstop in assisting the prosecutors prior to and during trial. On January 15, 1990, a lengthy trial began. At the conclusion of the trial, the jury found defendants Lundberg and Sanders guilty of conspiracy and embezzlement of pension funds. The defendants were subsequently sentenced by Judge Juan Bruciaga to serve 3 years in prison.

Thank you for your interest in this case. I would be pleased to answer any questions you may have.

Chairman PICKLE. Thank you, Mr. Crowe.

Now our next witness will be Bruce Ruud, who is the area director of the Pension Welfare Benefit Administration out of the Dallas office.

STATEMENT OF BRUCE RUUD, DEPUTY AREA DIRECTOR, DALLAS AREA OFFICE, PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. RUUD. Good morning, Mr. Chairman and members of the subcommittee.

I am the deputy area director of the Dallas area office of the Pension and Welfare Benefits Administration. I am pleased to be here today to discuss our civil and criminal investigations of the pension plan sponsored by Lundberg Industries, which covered some 840 participants.

Our civil case was opened on September 17, 1987 as a result of information received during August and September of 1987 from U.S. Senator Bingaman's Office, the Pension Benefit Guaranty Corporation, and the Dallas office of the inspector general for the U.S. Department of Labor.

Our investigation actually began on September 21 when investigator Elaine Brogden interviewed an attorney who had been retained by several plan participants who had been experiencing difficulties in obtaining benefits. Ms. Brogden also met with the Federal bankruptcy trustee, who had been appointed by the bankruptcy court in September of 1987 after the company went into chapter 11.

In February of 1988, Ms. Brogden obtained records from Mr. DeLuche which revealed that questionable loans had been made by the plans.

In December of 1987, the county district attorney had brought criminal charges against Thomas Lundberg, the president and principal owner of Lundberg Industries, three of his relatives, two of his associates, a former plan trustee who provided legal services to Lundberg Industries, and two other service providers. The charges concerned their mismanagement of Lundberg Industries and the making of fraudulent representations to a lending institution. The State criminal counts relating to the pension plans were later dismissed for lack of jurisdiction.

Our investigation revealed violations of the Employment Retirement Income Security Act, resulting from the improper loans to Mr. Lundberg and others of $4.1 million, the illegal reversion of plan assets to the plan's sponsor of $3.6 million, the illegal transfer of real property to satisfy a $1.5 million obligation to the plan, and the improper acquisition of Lundberg Industries stock of $900,000.

The documents provided by Mr. DeLuche that had been compiled during their investigation which lead to the State indictments were of great benefit to our investigation. In March of 1988, we submitted our reported investigation to our national office, and the matter was referred to the Department of Labor or solicitor's office for litigation in April of 1988.

Also in April, the Pension Benefit Guaranty Corporation took over the trusteeship of the plans. On October 5, 1988, the Department filed suit in the U.S. District Court for the Northern District of Texas in Dallas against Mr. Lundberg, former trustee John Sanders, and two associates of Mr. Lundberg, Joe Wall and Samuel Longo, citing violation of ERISA's fiduciary provisions resulting from the making of over $7 million in illegal loans and transfers from the pension plans.

The Pension Benefit Guaranty Corporation, as trustee, simultaneously filed a separate suit. The complaints sought restitution of over $7 million to the plan for the losses suffered by the plans, and for the money improperly received by the defendants.

In addition, the Department sought to have the defendants permanently enjoined from serving in a fiduciary capacity to any ERISA covered plan.

In March of 1990, the Department obtained a restraining order preventing defendants Lundberg and Sanders from disposing of personal and business assets without the prior approval of the U.S. district court or the Labor Department and prohibiting them from destroying or concealing any financial records relating to their assets.

This was done to prevent them from taking any action which would hinder our ability to obtain the restitution asked for in our complaint.

Also in March of 1989, the Department submitted a "motion for partial summary judgment" against the trustees with regard to the $2½ million in loans made to the company through Mr. Lundberg's business associate, Joe Wall.

In July of 1989, the court granted the Department's motion for partial summary judgment. At that point, the solicitor of Labor suspended the action so as not to interfere with the criminal proceedings.

Last month the solicitor's office filed additional pretrial motions and is moving ahead with the depositions of the parties involved.

After completion of the civil investigation and referral of the case to the Department's solicitor of Labor for litigation, the Dallas area office opened a criminal investigation on July 29, 1988. We had been granted delegation to conduct a criminal investigation from the U.S. attorney's office the previous day.

At this meeting, a copy of the "Report of Investigation" documenting the findings of our civil investigation was furnished to the assistant U.S. attorney handling the Lundberg matter.

Using evidence collected in the civil investigation and additional material provided by the U.S. attorney in New Mexico, a "Report of Investigation" addressing the criminal violations involving the Lundberg Industries employee benefit plans was prepared by the Dallas area office and presented to U.S. Assistant Attorney Robert Baca on December 6, 1988. Dallas area office personnel met with personnel from the U.S. attorney's office, the Department of Labor's Inspector General's Office and the Eddy County district attorney's office to finalize the issues prior to presenting the indictment to the grand jury.

In March of 1989, Lundberg, Sanders, Donaldson, who is a consultant to the plans, David Boatright, an actuary, and Samuel Longo were indicted on charges of mail fraud, aiding and abetting, and conspiring to embezzle over $9 million in pension funds.

Dallas area office investigators were available to provide technical assistance to the attorney preparing the indictment. Our investigator testified before the grand jury which entered the indictment.

Three of the four mentioned defendants pled guilty to reduced charges and testified as prosecution witnesses. In addition, Joe Wall, an unindicted coconspirator, pled guilty. In March of 1990, they received sentences ranging from 3 to 5 years probation and were ordered to perform community service.

The trials of defendants Lundberg and Sanders began on January 16 and continued through February 8 of this year. During the course of the trial, two investigators provided technical, research, and analytical assistance to the U.S. attorney's office. The PWBA national office also provided a witness to serve as an expert on ERISA should one be needed during the trial.

Following the trial, U.S. Attorney Baca wrote to PWBA investigators to thank them for their assistance in the case. Thomas Lundberg was convicted of six counts of embezzlement and conspiracy to embezzle, and John Sanders was convicted of three counts of embezzlement and conspiracy to embezzle more than $9 million.

Lundberg and Sanders have been sentenced to 3 years in prison and 5 years probation. We are proud of our actions in this case and believe that it represents an effective use of Federal, civil and criminal law to both recover money from the participants and punish those who broke the law.

Thank you, Mr. Chairman. I would be happy to answer any questions.

[The prepared statement follows:]

PWBA TESTIMONY BY
BRUCE RUUD
REGARDING LUNDBERG INVESTIGATIONS
FOR WAYS AND MEANS COMMITTEE HEARING

Mr. Chairman and Members of the Committee, my name is Bruce Ruud. I am the Deputy Area Director of the Dallas Area Office of the Pension Welfare Benefits Administration. Our office has jurisdiction over private employee benefit plans in Texas, Arkansas, Louisiana, Oklahoma & New Mexico. We are one of fifteen Pension & Welfare Benefits Administration field offices throughout the United States.

I am pleased to be here today to discuss our civil and criminal investigations of the pension plans sponsored by Lundberg Industries which covered some 840 participants. While I am prepared to discuss our office's entire activities in connection with this case, I should point out that my specific role was to supervise the civil investigation. Because of potential evidentiary problems we normally establish separate review chains for the civil and criminal investigations. The criminal case was supervised by Area Director Oscar Masters who unfortunately is ill and unable to be here today.

Our civil case was opened on September 17, 1987, as a result of information received during August and September of 1987, from

U.S. Senator Bingaman's office, the Pension Benefit Guaranty Corporation, and the Dallas Office of the Inspector General for the U.S. Department of Labor. Our investigation actually began on September 21, 1987, when Investigator Elaine Brogden interviewed an attorney who had been retained by several Plan participants who were experiencing difficulties in receiving benefits. Ms. Brogden also met with the Federal Bankruptcy Trustee who had been appointed by the Bankruptcy Court in September of 1987, after the company went into Chapter 11. In February of 1988, Ms. Brogden obtained records from Mr. Deluche of the Eddy County District Attorney's Office which revealed that questionable loans had been made by the Plans. In December of 1987, the Eddy County District Attorney had brought criminal charges against Thomas Lundberg (the president and principal owner of Lundberg Industries and a Plan trustee), three of his relatives, two business associates, a former Plan trustee who provided legal services to Lundberg Industries and two service providers. The charges concerned their mismanagement of Lundberg Industries and its employee benefit plans, and the making of fraudulent representations to a lending institution. The state criminal counts relating to the pension plans were later dismissed for lack of jurisdiction.

Our investigation revealed violations of the Employee Retirement Income Security Act resulting from improper loans to Mr. Lundberg and others of $4.1 million dollars, the illegal reversion of plan assets to the Plan sponsor of $3.6 million dollars, the illegal transfer of real property to the Plan to satisfy a $1.5 million obligation to the Plan, and the improper acquisition of Lundberg Industries stock of $900,000. The documents provided by Mr. Deluche, that had been compiled during their investigation which led to the state indictments, were of great benefit to our investigation.

In March of 1988, we submitted our report of investigation to our National Office and the matter was referred to the Department of Labor's Solicitor's Office for litigation in April of 1988. Also in April, the Pension Benefit Guaranty Corporation took over the trusteeship of the Plans.

On October 5, 1988, the Department filed suit in the U.S. District Court for the Northern District of Texas, in Dallas, against Mr. Lundberg, former trustee John Sanders, and two associates of Mr. Lundberg, Joe Wall and Samuel Longo, citing violations of ERISA's fiduciary provisions resulting from the making of over $7 million in illegal loans and transfers from the pension plans. The Pension Benefit Guaranty Corporation, as trustee, simultaneously filed a separate suit. The complaints sought restitution of over $7 million to the Plan for the losses suffered by the Plans and for the money improperly received by the defendants. In addition, the Department sought to have the defendants permanently enjoined from serving in a fiduciary capacity to any ERISA covered plan.

In March of 1989, the Department obtained a restraining order preventing defendants Lundberg and Sanders from disposing of personal and business assets without the prior approval of the U.S. District Court or the Labor Department and prohibiting them from destroying or concealing any financial records relating to their assets. This was done to prevent them from taking any action which would hinder our ability to obtain the restitution asked for in our complaint. Also in March of 1989, the Department submitted a Motion for Partial Summary Judgement against the trustees with regard to the $2.5 million in loans made to the company through Mr. Lundberg's business associate, Joe Wall. In July of 1989, the Court granted the Department's Motion for Partial Summary Judgement. At that point, the Solicitor of Labor suspended action so as not to interfere with the criminal proceedings. Last month the Solicitor's Office filed additional pre-trial motions and is moving ahead with depositions on the parties involved.

After completion of the civil investigation and the referral of the case to the Department's Solicitor for litigation, the Dallas Area Office opened a criminal investigation on July 29, 1988. We had been granted delegation to conduct a criminal investigation from the U.S. Attorney's Office the previous day. At this meeting, a copy of the report of investigation documenting the findings of our civil investigation was furnished to the Assistant U.S. Attorney handling the Lundberg matter. Using evidence collected in the civil investigation and additional material provided by the U.S. Attorney in New Mexico, a Report of Investigation addressing the criminal violations involving the Lundberg Industries employee benefit plans was prepared by the Dallas Area Office and presented to Assistant U.S. Attorney Robert Baca on December 6, 1988. Dallas Area Office personnel met with personnel from the U.S. Attorney's Office, the Department of the Inspector General's Office, and the Eddy County District Attorney's Office, to finalize the issues prior to presenting the indictment to the Grand Jury.

In March of 1989, Lundberg, Sanders, Donaldson (a consultant to the Plans), David Boatright (an actuary), and Samuel Longo were indicted on charges of mail fraud, aiding and abetting, embezzlement and conspiring to embezzle over $9 million in pension funds. Dallas Area Office investigators were available to provide technical and other assistance to the U.S. Attorney in preparing the indictment. Our investigator testified before the Grand Jury which entered the indictment. Three of the aforementioned defendants pled guilty to reduced charges and testified as prosecution witnesses. In addition, Joe Wall, an unindicted co-conspirator, pled guilty. In March of 1990, they received sentences ranging from three to five years probation and were ordered to perform community service.

The trial of defendants Lundberg and Sanders began on January 16, 1990, and continued through February 8, 1990. During the course of the trial, two investigators provided technical, research, and analytical assistance to the U.S. Attorney's Office. The PWBA national office also provided a witness to serve as an expert on ERISA should one be needed during the trial. Following the trial, Assistant U.S. Attorney Baca wrote to PWBA investigators to thank them for their assistance in the case.

Thomas D. Lundberg was convicted of 6 counts of embezzlement and conspiracy to embezzle and John Sanders was convicted of 3 counts of embezzlement and conspiracy to embezzle more than $9 million from the Lundberg Industries employee benefit plans. Lundberg and Sanders have been sentenced to three years in prison and five years probation.

We are proud of our actions in this case and believe it represents an effective use of federal civil and criminal law to both recover money for the participants and punish those who broke the law.

Thank you Mr. Chairman, I'll be happy to answer any questions you or other members of the subcommittee may have.

Chairman PICKLE. Thank you, Mr. Ruud.

I thank all of you gentlemen for your statements, and we will see that they are included in the record in their entirety.

Now, Mr. Hardin, can you hear me all right?

Mr. HARDIN. Yes, sir.

Chairman PICKLE. It seems that it's your determination to get information that brought these facts out. What made you suspicious of Tom Lundberg in the first place?

Mr. HARDIN. Well, sir, as a point of negotiation, we asked for documentation concerning the company's financial transactions and so forth. And one of those things would be ask, just ask about the money in the pension plan.

And also early on in the operation, one of the senior management members at the mine site approached me confidentially and told me that he felt something was wrong, some of the transactions taking place.

Chairman PICKLE. Did he indicate that Mr. Lundberg was actually stealing money from the plan?

Mr. HARDIN. He indicated he was afraid that he was. He had no way to prove or show that he did. He had no documentation.

Chairman PICKLE. Did you ask Mr. Lundberg of the company for a copy of their file; that is, the 5500?

Mr. HARDIN. We asked for summary annual reports. We asked for for the 5500. We asked for the actuary's working papers.

Chairman PICKLE. You did not get them at first, but you later got an incomplete summary of it?

Mr. HARDIN. Yes.

Chairman PICKLE. I am impressed with the statement. You said, we are a small union local with only 80 members, a small treasury, and no employees or full-time officers. There is no way we can deal with the bankruptcy court, IRS, the PBGC and the DOL by ourselves.

Mr. HARDIN. Yes, sir.

Chairman PICKLE. Now, you did contact your union here in Washington, and they looked at the form 5500 that had been filed, and on the surface, it looked all right. At least they couldn't tell anything was wrong on paper. Is that correct? But then you go on to say that in January of 1986, he, Mr. Lundberg, stole $2.3 million from our pension, whatever he had said in the papers he had filed, he was in our pension with both hands and feet, along with his buddies.

Now, obviously, you had difficulty getting information, but you did proceed from the tip you got from your top management.

Now, Mr. Lundberg is in jail along with some others, and about four or five of these people also had been aided in this, but just given probationary sentences.

Have you lost your pensions? Have you lost any amount of money in this——

Mr. HARDIN. Yes, sir. I lost $350 a month, after about 20-some years at that mine.

Chairman PICKLE. And that is true of yours and other workers out there. All right.

Now, Mr. Larry Crabtree, you were hired by Mr. Lundberg and Mr. Sanders, I guess, to represent them?

Mr. Crabtree. That is correct.

Chairman Pickle. Did you know them very well, either one of them?

Mr. Crabtree. I had never met them before.

Chairman Pickle. And then after you got suspicious of it, you couldn't get information. You withdrew from the case.

Mr. Crabtree. That is correct, because of what our disciplinary board said we had to do.

Chairman Pickle. Do you think that any of them, that is Mr. Lundberg or Mr. Sanders, realized that they were doing anything wrong?

Mr. Crabtree. From my dealings with John Sanders in hindsight, I honestly believe Mr. Sanders was doing this to cover his trail from having committed legal malpractice. I am not positive whether Mr. Lundberg knew what he was doing, other than he was getting a lot of money very quickly.

Chairman Pickle. Do you think, if you can make a judgment, that they were just concerned basically about civil penalties if they were apprehended in violation, and they had no thought, really, about criminal action being brought, but just civil action?

Mr. Crabtree. That is correct.

Chairman Pickle. Did you or any of you gentlemen think that the form 5500 contained all the information and data you needed? Was it specifically helpful to you in your review of this case?

Mr. Crowe. No, sir.

Mr. DeLuche. No, sir.

Chairman Pickle. It's about a 10-page document. Should we consider asking that it be revised, or in some way try to get additional information? Well, would you submit to us any suggestions you might have on this case?

I am going to make one other inquiry, and then I want to go to other members.

Mr. DeLuche, you represented the D.A.'s office in New Mexico, Carlsbad; is that correct?

Mr. DeLuche. Yes, sir.

Chairman Pickle. And you got brought into this action because a State suit was brought against this company?

Mr. DeLuche. Yes, sir.

Chairman Pickle. And you proceeded to gather information, but before you could get it or after, I guess, you did get an indictment, didn't you?

Mr. DeLuche. Yes, sir, through the State grand jury; yes, sir.

Chairman Pickle. And then the State threw that out because of Federal preemption?

Mr. DeLuche. Didn't throw the entire indictment out, but did throw those sections involving the pension fund out based on jurisdiction.

The court felt it should be Federal.

Chairman Pickle. At that point, then, you referred the case to the Federal Government, they came in at that point?

Mr. DeLuche. That is when it became much more active, during that time period. Actually, Mr. Crowe had come down in the month of June, and we were gathering up—whether it be State of Federal, we had already agreed to consolidate our files and move forward.

But that was at that time when the case, yes, part of it was dismissed.

Chairman PICKLE. Well, it's interesting to me that the participants tried to get some action, couldn't get any information, went to whatever sources they could, and couldn't get action.

They finally went to the State to look into the pension plan, and after you did, made certain findings.

The court said, no, these are Federal pensions, and you have no jurisdiction. It would seem to me it was very difficult to get the Federal Government involved in this thing. Fortunately, at that point, you and Mr. Crowe came together and he got into the case.

Mr. DELUCHE. Yes.

Chairman PICKLE. And Mr. Crowe saw it through in good manner, so I commend you for your perseverance. It seemed to me, though, that we were late getting into this picture. It makes it awfully difficult for any local pension fund to even know how to start. There was a conviction in this case, and a couple people put in jail for it, but it was justice the difficult way, we will say, and some people have lost their pension funds in the meantime.

So I think this case illustrates typically what happens to a lot of the smaller plans all over the country, that the department really cannot cope with many of the small plans, and they are standing in jeopardy.

I am going to ask Mr. Schulze now if he has any questions because I want to yield to any other members.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman, and I thank our panel.

I want to reiterate what the chairman has stated in regard to changes in form 5500. It would be most helpful for us if you would sit down and make a succinct recommendation for specific changes and/or deletions in the existing form.

Do any of you have any suggestions on how misconduct in this instance might have been detected earlier? It seems to me it was detected fairly earl, but is there a system or a structure or any suggestions that you have that might detect such things at an early stage?

Mr. Crabtree.

Mr. CRABTREE. I suggest that at any time an individual is permitted to serve as a trustee of a qualified plan, as opposed to a bank trustee or when the funds are not, let's say, fully insured through an insurance company, that some greater constraints, licensing, education requirements, whatever, be placed on individuals in trustee positions.

I think that is a very good start.

Mr. SCHULZE. Anyone else have any suggestions?

Mr. CRABTREE. I have got a lot more, but I will summarize them in a separate letter.

[The following was subsequently received:]

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June 29, 1990

The Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth Building
Washington, DC 20515

RE: Subcommittee on Oversight Hearing on the Enforcement and Administration of the Employee Retirement Income Security Act of 1974, Held on June 12, 1990

Dear Mr. Pickle:

This letter is provided to supplement my statement before the Subcommittee at the hearing held on June 12, 1990. I had advised that I would provide certain additional suggestions as to changes which might be made under the Employee Retirement Income Security Act of 1974 (ERISA) in an effort to curb abuses with respect to the assets of qualified retirement plans.

During the course of questions being put to the panel of which I was a part, certain issues were raised with respect to the audit of the Lundberg pension plans, particularly with respect to why the audit did not provide sufficient information to clearly inform the Internal Revenue Service and the Department of Labor as to the problem transactions which had occurred under the pension plans. In response to some of that questioning, Mr. Stephen Crowe made a statement to the effect that the auditors looked at certain documentation on the surface and that, on the surface, some of the documentation had some legitimacy. A transaction in point to which he alluded was the Joe Wall transaction.

In regard to the Joe Wall transaction, while the documents themselves appear to be in proper order, the actual transaction consummated by those documents was clearly, on its face, in violation of ERISA Section 406(a). I was afforded the opportunity to view those documents in preparation for my testimony in the criminal trial of Messrs. Lundberg and Sanders. The documents which had been prepared by some other attorney reflected a loan of plan funds to Mr. Joe Wall, the use of those funds by Mr. Wall to purchase certain encumbered assets from Lundberg Industries, Ltd., the pledging of those assets back to the plans as security for the loan to Mr. Wall, and the leasing of that property directly back to Lundberg Industries, Ltd. Those described transactions could readily be discerned as either an "indirect" (1) sale or exchange of property between the plan and a party in interest; (2) lending of money or other extension of credit between the plan and a party in interest; or (3) transfer to, or use by or for the benefit of, a party in interest of any assets of the plan. It appears that the accounting firm performing the audit of the plans either did not have sufficient knowledge of ERISA prohibited transactions to ascertain that the transaction in question was prohibited or did not believe that it was their responsibility to make such a decision and report their opinion on such transaction in their formal audit.

I believe that specific obligations should be imposed on any accounting firm assuming the responsibility to perform an audit on qualified retirement plans or health and welfare plans. That affirmative duty would require the auditing firm to immediately report to either the IRS or Department of Labor any such transaction revealed during the process of the audit. The requirement to so report should be within 30-60 days of the actual discovery of such transaction, rather than in the audit report filed with the annual report/return some seven months after the plan year in which any such transaction would have occurred.

I believe that, all too often, the firms providing audit services with respect to qualified plans may do nothing more than simply track cash flow and assets under the plan. It was suggested to me that the accounting firms may not be desirous of being saddled with the responsibility for finding and reporting prohibited transactions under ERISA. However, if any accounting firm does not wish to assume the responsibility for determining whether a given transaction is prohibited or not, they could simply retain the services of an outside pension attorney qualified to render an opinion on the matter. The requirement that the auditing firm disclose to appropriate federal agencies any such transactions uncovered should not appear to be precluded by any ethical or legal constraints, since there is not a relationship which generates a privilege, such as the attorney-client privilege, precluding the accounting firm from disclosing such information. Direct disclosure by the auditing firms on a separate reporting form designed expressly for such purpose would more readily bring such violations to the attention of the appropriate federal agencies than would the inclusion of a statement in the audit report accompanying the standard filing of the annual report/return for the given plan.

I believe it would also be advantageous to require specific licensing through an appropriate federal agency for any firm which desires to perform audits for qualified plans. If the members of the firm performing the audit of a qualified plan are not educated with respect to the governing rules under ERISA, they cannot be expected to discover and report violations of ERISA. Some type of certification similar to that used in the enrollment of actuaries with the Internal Revenue Service should serve to make the firms which provide plan audits more attuned to the underlying transactions so that they will be better able to determine whether such transactions should be reported.

As I addressed briefly in my written statement to the Subcommittee, I feel that it would also be appropriate to impose additional licensing requirements on any practitioners who work in the qualified plan area. As a practicing attorney, I would have no reservations about taking any appropriate exam or satisfying any other licensing requirements that might be established by Congress and administered either by the Internal Revenue Service or the Department of Labor for properly certifying that any given practitioner is sufficiently informed as to the governing law in order to properly advise clients. While the State of Tennessee does not recognize nor certify specialists in the law, the licensing requirement to which I am alluding could be in the nature of that required for attorneys practicing before the U. S. Patent Office. I believe that the existing and increasing complexity of the federal pension laws sufficiently warrant special licensing to insure better compliance with ERISA.

Questions were raised at the hearing as to suggestions to improve the Form 5500. In this regard, my suggestions tend toward procedures designed to take complete responsibility and authority for the signing of such forms from the parties who may be engaged in any prohibited transaction. I see no reason why return preparer liability, similar to that required with respect to tax returns, cannot be imposed with respect to the annual report/return required for qualified retirement plans and for health and welfare plans. There is no question that such requirement might increase the cost associated with the preparation of a return for a given qualified plan; however, my experience has been that, all too often, the return for the retirement plan is often prepared by the accounting firm which prepares the tax return for the sponsoring employer under circumstances where the plan return preparation is thrown in by the accounting firm as a bonus under the fees charged for preparing the employer's tax return. In many instances, very little time or thought is put into the preparation of the qualified plan's annual report/return.

In conjunction with instituting a requirement in the nature of tax return preparer liability, there might also be imposed a requirement that any firm, whether it be an accounting firm or otherwise, engaged in the preparation of the annual report/return for qualified plans be specially licensed or certified by the IRS to insure better compliance in the reporting procedures. I have often seen problems arise because a given firm engaged in preparing annual pension returns provides the sponsoring employer with incorrect advice as to a proposed transaction. In some instances, the return preparation organization is set up in conjunction with insurance companies or securities brokers, and the servicing organization may tend to be simply a tool to assist the insurance agents and securities brokers in placing products in the qualified plans. If certain investments are of a questionable nature, they may tend to be overlooked by the servicing organization which may be controlled by a principal of the insurance agency or securities broker. If greater responsibility were imposed upon the servicing organizations by requiring a principal of such organisation to sign the annual report/return under circumstances imposing return preparer liability, perhaps some of the problems could be avoided to the extent they relate to failure to properly report questionable transactions on the Form 5500.

Another suggestion with respect to the Form 5500 would be to require some independent verification that the fiduciaries under the plan are properly insured as required under ERISA. Perhaps a separate certification could be required from the insurance company providing the fidelity bond to be attached to each year's Form 5500 to properly certify that the plan's fiduciaries are insured as required. In turn, I suggest that the current limits on the insurance requirements for the fidelity bond are much too low and should be raised.

In response to one line of questioning during the hearing, I suggested that individual trustees should perhaps be licensed or otherwise be subject to certain education requirements when they are serving as trustees of qualified plans in lieu of there being either a bank trustee or a plan fully insured through an insurance company. Perhaps either the IRS or the Department of Labor could be involved in educational programs sponsored periodically in major cities to which individual pension trustees could go for an overview of the ERISA requirements and updating as to changes in the law. Perhaps any individual who is serving as a pension trustee could be required to attend one such training session every two to three years with a certificate of attendance issued to that individual for inclusion with the filing of the Form 5500 to demonstrate that the plan's trustee has satisfied such requirements. In my experience, I have seen individual trustees taken advantage of by consultants attempting to broker products into qualified plans due to the readily available assets for investment purposes. If the individual trustees were better apprised of the ERISA constraints, perhaps some of these abuses could be avoided.

A specific practice with which I have had problems in assisting clients with qualified plans is in regard to the sales of various limited partnership interests into qualified plans. These limited partnership investments in qualified plans create numerous problems, including the fact that such investments are highly illiquid and the fact that they are not regularly and properly valued in order to facilitate any plan's properly reporting the values of such assets held in the tax-exempt trust. When these types of investments are held by qualified plans which are in the process of termination, such assets normally cannot be sold, except at a distress sale, and cannot be properly valued for purposes of transferring out such assets in kind to one or more of the participants under the plan. I suggest that the sales of limited partnership interests into qualified plans be prohibited except under such circumstances where the general partners of those limited partnerships are required to provide regular market value appraisals of the partnership units and are required to create a secondary market for the sale by a qualified plan of any such units to avoid a potential forced sale in a distress situation.

Given time, I can arrive at numerous other suggestions as to changes which might help avoid abuses under qualified plans. I would be happy to continue to work with the Subcommittee's counsel in this regard if the Subcommittee so desires.

Sincerely,

KING & BALLOW

Larry D. Crabtree

Larry D. Crabtree

Mr. SCHULZE. That is fine.

That is all the questions I have, Mr. Chairman. Thank you.

Chairman PICKLE. Mr. Dorgan.

Mr. ANTHONY. Mr. DeLuche, after you got into the case, what do you personally think was the most important evidence that you were able to discover?

Mr. DELUCHE. I think documentary, a lot of that evidence was important. Also, I had some telephonic interviews which what turned into being defendants where they agreed to talk to me over the telephone, and I think that literally broke their back later on, where they agreed to be states witnesses and obtain plea bargains.

Mr. ANTHONY. How were you able to obtain that evidence? Just with your general investigatory authority.

Mr. DELUCHE. Yes, sir. Yes, sir. Basically when the case started, we were looking for crimes that our State would have jurisdiction in.

Mr. ANTHONY. Such as?

Mr. DELUCHE. Sale of encumbered property where the mining equipment was sold to Mr. Wall, that was what we felt we certainly had jurisdiction in.

Mr. ANTHONY. So you went beyond the insurance and the vendor debt problems?

Mr. DELUCHE. Yes, sir.

Mr. ANTHONY. And you just leapfrogged that into a criminal activity, and you tried to center on State authority first?

Mr. DELUCHE. Yes, sir, as many of the counts as possible, yes, sir.

Mr. ANTHONY. Why did you go State rather than Federal at the beginning?

Mr. DELUCHE. Basically first of all, we had no choice once the grand jury was impaneled to proceed with evidence before the grand jury. That is a 90-day short fuse.

Too, there was not much in the way of Federal movement at that time, at least in the opinion of the district attorney.

Mr. ANTHONY. I mean, in other words, why did he make that decision?

Mr. DELUCHE. Why did the district attorney decide to go State?

Mr. ANTHONY. Yes. You said he went State because he didn't see any evidence of Federal movement.

Mr. DELUCHE. Because there wasn't any evidence of Federal movement. There had been meetings attended by the inspector general's office. There had been telephonic conversations between my boss, the district attorney and the U.S. attorney, and the attorney general for the State of New Mexico. It was decided that we had evidence that we could move forward on, and the State moved.

Mr. ANTHONY. So there was some areas that you would have preferred to get into, but because of your lack of jurisdiction on the Federal level, you were handicapped, and because there was not full involvement at the early stages with Federal agencies or authorities, you were handicapped to some extent in your evidence gathering mechanisms?

Mr. DELUCHE. Again, as reflected in my report, we were informed that this material was 6E material. Grand jury material was not available to us, so we couldn't move forward with what was being gathered at the Federal end.

Later on, as I continued to work with the inspector general's office, I did have that material made available to me. I was a 6E, under the 6E exemption.

Mr. ANTHONY. Two final questions of you. What is your investigative training? What formal training have you received prior to this case?

Mr. DELUCHE. Prior to this case, I was chief criminal investigator in the State of Colorado for the sixth judicial district. I have a college education. I have been trained. I could list numerous schools. I don't know if you want me to go school by school, but I have been doing this for 19 years.

Mr. ANTHONY. 19 years.

Mr. DELUCHE. Yes, sir.

Mr. ANTHONY. Experience in criminal investigation?

Mr. DELUCHE. Criminal investigation, yes sir.

Mr. ANTHONY. You keep referring to the State cases, and then you said to Mr. Pickle that all of them were not dismissed.

Were any of the State cases taken all the way to trial and conviction?

Mr. DELUCHE. No, sir. When the State court dismissed the pension fund cases, that became an appellate issue. The State's attorney general's office appealed that to the court of appeals. That stayed the State case until completion of the Federal case.

Mr. ANTHONY. So then all State cases were eventually dismissed?

Mr. DELUCHE. All State cases were eventually dismissed, yes, sir.

Mr. ANTHONY. Mr. Crowe, the evidence that Mr. DeLuche was able to obtain, did you find it useful?

Mr. CROWE. Found it very useful, sir. Mr. DeLuche is being very shy about his background. He's a very experienced investigator. When we got together and began to work together, the files that Mr. DeLuche put together, put together in an appropriate manner of criminal investigation. All his documents were indexed. They were indexed as to where he obtained them, who can testify as to the document, who can identify it in court.

His witness interviews have the appropriate notes. They are done in an appropriate format for presentation to a grand jury for criminal charges. His witness briefs were done in a manner such that you can turn them over to a prosecutor and the prosecutor can prepare for a trial based on those briefs.

Surprisingly, I found it very valuable. He worked the case essentially the same way our agents worked the case.

Mr. ANTHONY. Were you able to obtain evidence that he was unable to obtain?

Mr. CROWE. No, sir. I think all evidence available was available to both parties, in my opinion. But what we were able to do once we got together on the State charges and the embezzlement charges being dismissed, is we were able to supplement each other's records.

Rather than two, I might have on certain issues of the investigation, better records, more detailed records, more original documents of Mr. DeLuche, whereas on other counts, other allegations involved on the case, Mr. DeLuche has better records.

We were able to merge and supplement each other's efforts and coordinate each other's efforts and divide up the interviews that still needed to be completed in the case, divide up the preparation of the documents for trial.

Mr. **ANTHONY**. I will yield to the chairman.

Chairman **PICKLE**. Mr. Crowe, in that connection, at the time that these funds were being embezzled, was there any kind of audit being made of the pension funds?

Mr. **CROWE**. The pension funds specifically was supposed to be audited annually. They never did complete their annual audit. It was not completed for the pension fund.

The pension fund indirectly was audited by the auditing firm of Ernest & Whinney as part of a financial audit Lundberg Industries. That financial review did not detect any problems whatsoever with the pension plan.

Chairman **PICKLE**. So, even though there were audits, you couldn't tell much from them; it really wasn't that helpful to you, was it?

Mr. **CROWE**. The auditors looked at the documentation on the surface and on the surface only, when you look at the Joe Wall transaction, it has some legitimacy. There are mortgage documents filed. There are mortgage documents prepared as if a real mortgage exists. There are financing statements that exist that would appear that the transaction was legitimate.

If you look at the surface of that, it will pass an audit, if you go a little further and find out one, do they actually own the equipment listed on the mortgage; two, was the mortgage ever filed, that is where you will detect a problem.

But on the surface, the audits never disclosed it. The 5500 forms did not disclose it, as well; but they are also not accurate. They are filled out by the parties involved in the case.

Chairman **PICKLE**. All right. I thank you.

Thank you, Mr. Anthony.

Mr. **ANTHONY**. Mr. Crowe, do you agree with Mr. DeLuche on what was considered to be the most important evidence that was gathered, or do you have other pieces that you think were as important?

Mr. **CROWE**. I agree with Mr. DeLuche in general that the actual obtaining the documents, the original documents themselves, was probably the most important part of the case, because it was a paper case.

But second, the interviews of the defendants became very, very important. The recorded interviews that he did, that were done in a law enforcement manner such as they can be introduced in court were very valuable to us because the two defendants actually made several significant oral admissions that were recorded on the phone conversation. They could be introduced in the trial.

It led, in my opinion, to those two defendants being very anxious to cooperate with the Government in plea negotiations, and the use of the testimony of those two defendants made the success of the trial much easier.

Mr. **ANTHONY**. That is good. Would you just quickly state for the record some of your investigative credentials?

Mr. **CROWE**. I am a graduate in criminal justice of the University of Texas system. I have spent 14 years doing nothing but criminal investigations.

Initially with the U.S. Department of Agriculture's Office of Inspector General in rural rental loan fraud cases, construction fraud cases, I spent 2 years in Albuquerque, N. Mex. on the State directed investigation task force, which is basically a State organized crime task force.

I then left that task force for the U.S. Department of Labor's Office of Inspector General where I have done nothing but criminal cases, both as an individual agent and as a team leader of criminal investigators.

From an experience level, I work criminal cases. My—the prosecution of those cases, it's 200 or 300 cases.

Mr. ANTHONY. Of the cases that you have handled in the past, how complex would you consider this one?

Mr. CROWE. This case is complex. It's not as complex as other investigations I have done. It's lengthy because of the enormous number of documents involved, and the enormous number of financial accounts that these people used and manipulated.

It's a complex case, but it's not the most complex case that I have ever encountered.

Mr. ANTHONY. Thank you very much.

Mr. Ruud, did you personally work on the investigation of the case with the PWBA when it was brought to you attention?

Mr. RUUD. No, sir, I did not actually conduct the investigation, but I did supervise those individuals who were working on the civil investigation.

Mr. ANTHONY. How many staff people did you have assigned to the civil?

Mr. RUUD. On the civil case, we only had one investigator assigned, and I believe she was assisted on one or two occasions by some junior investigators that we had in the office.

Mr. ANTHONY. What evidence did your investigators uncover?

Mr. RUUD. Essentially, like these gentlemen, most of our evidence was documentary evidence that we obtained from Mr. DeLuche, in large part, which was extremely helpful to our investigation and streamlined our investigation a great deal because Mr. DeLuche in the district attorney's office had already collected so much of the evidence and cataloged it and put it in a very logical order.

In addition, we developed a great deal of information from the trustee who had been appointed by the U.S. Bankruptcy Court, and who had possession of many of the records for Lundberg Industries and some of the records for the plan.

In addition, we did some interviewing as well.

Mr. ANTHONY. Do your civil investigators rely on any criminal type investigatory skills or tools to uncover evidence?

Mr. RUUD. Congressman Anthony, we conduct both civil and criminal investigations in PWBA. Certainly the majority of our investigations are civil in nature. All of our employees go through a 3-week basic training course which spends a little bit of time dealing with criminal law and criminal investigative procedures. But the majority of that course deals with civil investigations.

In addition, some of our people have been trained at the Federal Training Institute at Glynco, Ga. We are trying to get more and more of our investigators sent to that training.

Also, next week we are beginning a 1-week criminal course where we will send 20 or 30 of our investigators and hopefully that will be an ongoing course that we can use in our agency.

Mr. ANTHONY. I didn't mean to cut you off.

Mr. RUUD. Some of our investigators have criminal investigative backgrounds from jobs that they have had.

Mr. ANTHONY. That was going to be my next question. The person that was assigned in this particular case, did he have as extensive a criminal background as Mr. DeLuche and Mr. Crowe?

Mr. RUUD. No, sir.

Mr. ANTHONY. Do you have anybody on your staff that has that type of extensive criminal background?

Mr. RUUD. The investigator assigned to this case does not have a criminal investigative background. I have an investigator who does a great deal of criminal work in the Dallas area office who spent, I think it was 16 years with the New Orleans Police Department and was an investigator with the Corps of Engineers after that doing primarily criminal investigations.

That person is often assigned the criminal work that we have.

Mr. ANTHONY. From hearing all of the witnesses testify today, it appears that most went right after the criminal activity level, and, in fact, your office was put on notice as early as December of 1987 by the State of New Mexico of criminal activity.

It was not until—if my notes are correct, it was not until March that you sent the report to the IGA and the IGA made a recommend that some type of—IG with DOL get involved in the criminal side.

And it was not until December of 1988, a full year later, that the Federal component engaged directly in criminal indictments, yet the State was ahead of them by 1 full year.

I must admit that disturbs me somewhat, and it appears also from your testimony that you were more centered toward civil and less towards criminal, and I am just curious as to what is the policy within PWBA in terms of seeking civil penalties.

I don't dismiss the fact that recovering property and recovering money is not important, but it seems to me that you can track an investigation from day one without treading on the toes of the evidence and/or of the procedure.

Actually, from having had over 10 years of trial experience as a prosecutor, I can see sometimes where a civil investigation can tread on the criminal elements if you do not coordinate, incorporate from day one.

I am a little bit concerned about the policy that may exist. Could you just try to briefly state, as the officer in charge, how do you determine from day one that you will go after civil and at what point in your decisionmaking or in your own manual would it flip over to criminal so that you could get a Mr. DeLuche or Mr. Crowe involved?

Mr. RUUD. Yes, sir, I will try to do that.

I would say that ordinarily in the course of conducting investigations at PWBA, we would center or focus initially on the civil investigation.

I think the policy of PWBA for many years has been to protect the assets and protect the plan participants and beneficiaries.

I very much agree that many of the fiduciary and the people out there that are committing these fiduciary breaches and reeking havoc on these employee benefit plans need to go to jail.

But I think our first line of defense, at least in our agency, is to go after the money and see if we cannot seek some restitution back to the plan so that people like Mr. Hardin don't have to lose the $250 a month that they have been promised by the Lundberg Industries' plans.

I think we try to also temper that with recognition of our obligation to conduct criminal investigations, as well. Sometimes we conduct civil and criminal investigations simultaneously. That in itself is fairly labor intensive.

Generally we use separate investigators for the civil investigations; and for the criminal investigations, we have a separate chain of review for these investigations.

It tends to be very labor intensive.

Mr. ANTHONY. Let me stop you there a minute. Would the mere fact that you have split jurisdiction within your PWBA, would that be an element that should be reviewed?

In other words, you make the decision that because you have split jurisdictions, you are going to have a lot more people, a lot more pieces of paper to review.

It's got to move up here before somebody looks at it. It seems to me that that might be a checkpoint that you could take a look at in terms of trying to smooth out the difficulties of moving in a two-step tier.

Mr. RUUD. I think that is correct. Resources are very, very critical in PWBA.

Mr. ANTHONY. It also disturbs me a little bit that you have only put them through a 3-week basic criminal training course. You get a complex case with a hundred different transactions in terms of entities, and somebody with 3 weeks of experience could do two things. One, they could say, hey, this one is too tough. I believe I will just go the civil route.

And second, could just be so complex that they might not do what Mr. Crowe just said that any normal investigator who's got a lot of experience would do, and that is go beyond the mortgage to see if the property is there and if you own it and—as they finally did.

Who found out that they owned the bank down in Texas and that they were sitting on the board of directors?

Mr. DELUCHE. We found that out fairly early.

Mr. ANTHONY. Fairly early.

Mr. DELUCHE. Yes, sir.

Mr. ANTHONY. Well, I am going to close out by—I guess by challenging all of you to find a way to have that utmost early cooperation between the criminal and the civil.

And I do not—I do not say that civil is not extremely important. But if there is a red flag out there that indicates there may be some criminal activity, it appears then that it is the perfect opportunity to put all of the component parts in a room together, and if you have to, draw up a cooperative document detailing what each's responsibilities are.

But I would just say to you, Mr. Ruud, don't ever lose out on having the opportunity of having a Mr. Crowe or a Mr. DeLuche go out and do some work for you.

When I was a trial prosecuting attorney, if I had gotten a report from Mr. DeLuche the one Mr. Crowe just described, I probably would have been elated. I might have won a few more cases, too.

So I know the complexity of these cases, but I also know that if you start off with the idea of cooperation, both on civil and criminal, that maybe you won't have that year's delay between whether a State says there is criminal activity and whether it took the Federal Government to come around.

I bet the prosecutor out in New Mexico is laughing saying, I was a full year ahead of the prosecutors on the Federal side, and I would like to see it the other way around.

Thank you, Mr. Chairman.

Chairman **PICKLE**. Mr. Chandler.

Mr. **CHANDLER**. Thank you, Mr. Chairman.

It seems to me that what we want to ask ourselves as we discuss this case with this panel, and others, is did the system work; were the plan beneficiaries and participants protected? Did the system work in this case?

The thing that concerns me is that we know workers are losing benefits every single day, not because somebody has done like Lundberg and cheated the system, but because other plan sponsors, overwhelmed by Federal regulation of their pension plans, simply throw up their hands and terminate the plan.

That is the big business in the law today. Mr. Crabtree is nodding his head, yes, he is terminating plans, too, it would be my guess, for plan sponsors. That, I believe, has to be the word of caution to ourselves as we approach this.

So in that spirit, I would like to ask some questions. Mr. Hardin, you said that you had lost 350 percent per month in your pension. I am curious why that is. What was it that was promised that you did not receive from your Pension Benefit Guaranty Corporation as a guaranteed benefit?

Mr. **HARDIN**. Congressman Chandler, you are asking me why I wouldn't receive a benefit?

Mr. **CHANDLER**. Well, you said you lost 350 percent a month, and I am not clear on why that would be.

Mr. Crabtree, if you know, that would be fine to answer that.

Mr. **CRABTREE**. The PBGC insures the benefits only to certain levels. To the extent that he had accrued benefits in excess of those levels, they are not insured. So if the assets are gone, there is no money to pay those benefits.

Mr. **CHANDLER**. My understanding is the monthly benefit cap is $2,164 per month in 1990. Is your benefit that high?

Mr. **HARDIN**. The reason I lost the benefit, Congressman, is because of the age level, the cutoff date. At the time I was under 55. If they had terminated the plan the way it was, and it was a partial cash payout; however, not qualified for benefits under a negotiated 7080 provision of the contract, and it was disallowed. And I would have received the full $350 under the 7080 provision.

Mr. **CHANDLER**. Either Mr. Ruud or Mr. Crowe, as you know, the Pension Benefit Guaranty Corporation has first lien on the assets of a company in a case like this. Do you know if PBGC was essentially reimbursed for its expenses by the assets of the company, or has it gone far enough yet for that to take place?

Mr. **Ruud**. I do not believe that PBGC has been reimbursed for the amounts that they have had to fund in the Lundberg Industries case.

Part of the reversion, the illegal reversion of $3.6 or $3.7 million, the Department and PBGC received a summary judgment for. I think it was $2.8 million or $2.5 million that was recovered from that illegal reversion.

But I think the PBGC still has a liability here. I don't believe that the withdrawal liability has done it much good. I may be incorrect on that, but that is my understanding.

Mr. **Chandler**. You don't know if there are assets still in existence which could be utilized to reimburse PBGC?

Mr. **Ruud**. I really don't.

Mr. **Crowe**. The exact figures I am not aware of. That process is ongoing. There are some assets out there that are tied up into real estate that has multiple partnership arrangements.

What the current value of that real estate will be, if that real estate will ever accrue in value and be sold by the other partners such as PBGC would be able to actually in effect have money in hand based on its summary judgments is a future type situation.

A little bit of caution in the summary judgment. Yes, we got a summary judgment for $2.8 million. A summary judgment can be worth $2.8 million. It can also be worth nothing.,

Mr. **Chandler**. Clearly.

Mr. **Crowe**. It's just a judgment. It's not real money.

Mr. **Chandler**. I understand.

Mr. **Crabtree**. One point I made in my statement was the Aetna Insurance Company was keeping assets for $9 million to insure benefits worth $7 million and to my understanding of ERISA and what Congress had intended from the legislative history, they had enough control they were fiduciary.

I understand PBGC settled that lawsuit for $900,000, which is about where I had advised Lundberg and Sanders that we might settle to avoid a lawsuit that might cost us $1 million to fight.

But there is about $1.6 million more in assets held by Aetna under contract rates that are not fair to the plan. I know the insurance lobby is big in Congress, but I believe group annuity contracts should be made to be more responsible to the needs of the participants and not the profits of the insurance company.

Mr. **Chandler**. Maybe that is something we can pursue. In your investigation, and Mr. DeLuche, maybe your are the best to answer this, was there anything lacking in Federal law in ERISA that made it more difficult to bring these people to justice?

Do we need to tighten the law, toughen it up in any way?

Mr. **DeLuche**. My experience—and again, my Federal experience is somewhat limited. But having prepared basically the indictments at the State level, and then assisting Mr. Crowe in preparing the indictments at the Federal level, reviewing the law, I think the law was very, very well written.

Mr. **Chandler**. What would be helpful to you, Mr. Ruud or Mr. Crowe, in terms of discovery?

First of all, how typical is a case like this? Among the millions of plans that exist, how many of those kind of cases do you expect to encounter? Is this typical, or highly unusual?

Mr. RUUD. I would characterize the Lundberg case as a very egregious case in terms of PWBA. It is unusual, I think. Most of the violations we uncover, are not of this impact and this amount.

In the Dallas area office last year, I think we recovered voluntarily between $8 and $9 million for participants in our jurisdiction. This case alone involves $9 million.

I think one of the things about this case that makes it so difficult is the fact that the violations were concealed. There was concealment here and it didn't appear on the annual report form 5500. We have made many revisions, starting in 1988 to the annual report form, but I think criminals such as Lundberg and Sanders and others, as long as they are concealing the facts from the accountants and from those who prepare the 5500, can be real difficult for us to target from the 5500.

This case came to us, of course, as a referral from Senator Bingaman's office and the OIG and PBGC. A number of participants contacted us and gave us allegations of violations. Unfortunately, in the Lundberg case, we did not hear about the violations until August of 1987. The participants were dealing with the district attorney's office and perhaps there is a visibility or credibility problem that we have in Dallas with our program, but we just didn't hear about it. Had we heard about these violations and the amounts involved, I think we would have acted more quickly.

Mr. CHANDLER. Do you need more authority, and more resources? I believe in response to Mr. Anthony you did say, yes, you need more resources. If you had that, could you do some spot checks? Could you do some routine surprise audits that might, for one thing, warn the Lundberg's that are still out there that they are not going to get away with this? And also, you might discover some cases that could be prosecuted?

Mr. RUUD. I would think so. With 300 investigators nationwide, and the 4½ million welfare plans and the 900,000 pension plans, clearly we are very strapped for resources. We really just answer the complaints and inquiries we get, and also those plans that we can target from the annual report form 5500. We really examine just a very small portion of our plan universe each year. How much we could handle, you know, I don't know. But I think we are very strapped for resources.

Mr. CHANDLER. But again, it is your opinion that the behavior of this kind by plan sponsors is unusual, extremely unusual?

Mr. RUUD. Yes, sir. I think it is. I think that a case this egregious is very rare; I hope there are not a lot of other Lundbergs out there that we just don't know about. I mean, that certainly is a real fear. I just don't know. I don't know the limits of these types of situations.

Mr. CHANDLER. All right.

Thank you, Mr. Chairman.

Chairman PICKLE. Well, I thank you, Mr. Chandler.

We must go to our other panel, but it seems to me that the testimony this morning has shown the emphasis has been placed, in the past, and even now, on civil action. The focus has been on seeing that the assets are protected, replacing them, putting the money back in, and less emphasis has been put on any kind of criminal action. And in answer to Mr. Chandler's question, "Do you need more criminal laws?" Mr. DeLuche, and I think Mr. Crowe both have said, we have criminal laws on the books that we can follow, but we are just not enforcing them.

It seems to me the emphasis is almost entirely on civil action and not on criminal action. I don't know that we as a committee can now come to any conclusion as to where the emphasis ought to be on that. We will have testimony on that question in particular tomorrow.

But, I think it is obvious that the Federal arms of pension enforcement were very reluctant to get into this case. If it hadn't been for Mr. Hardin demanding rights, demanding information; and Mr. DeLuche and Mr. Crabtree insisting that there was something wrong, I doubt that we would have had anything. We were a year behind, maybe more, in getting involved.

And so the question is, at what point and how can we get involved? I am interested in knowing one thing, Mr. DeLuche or Mr. Crowe, either one of you, how did you track down the money, the $2.3 million or whatever it is, that went from the plans to Mr. Wall, I guess it was, his loan? How did you all track that down? How did that come about?

Mr. Crowe. Once we looked at the assets, when the plan went into bankruptcy and the file for assets, one of the only assets shown in the corporation was a loan note payable from Joe Wall to one of the three pension plans.

We then looked into—Joe Wall made himself available for interviews. Mr. Wall, not being an idiot, realized that this game was up, contacted Mr. DeLuche. He also contacted agents at our office, offered to cooperate. He made the statement that people say I took $2 million out of this pension plan, I didn't do it, I have records that show that I didn't get the $2 million.

He brought his records forward. They had the account numbers on there, significant enough that we were able to obtain those bank accounts and analyze who actually got the money and in whose pocket it went into.

Chairman Pickle. Who did get the money?

Mr. Crowe. When you divide out—Joe Wall is actually two transactions. It is a $2 million embezzlement that occurred not 30 days after Mr. Lundberg got the money, but within 49 hours of when Tom Lundberg and John Sanders actually took custody of the first cash from Ideal Basic and the pension plans.

When you analyze who got that, the attorney, John Sanders, took $1,047,000. Approximately, and I use approximate numbers, about $½ million of that $2 million went to pay the permanent debts that were overdue of Tom Lundberg on real estate, and on personal loans that he had obtained to keep from being prosecuted over a check embezzlement that he had committed earlier in the year.

Chairman Pickle. Well, that is very interesting.

These are all complex cases. We thought a review of this case, which has been adjudicated, would show us the enormity of the problem, particularly when you are dealing with small cases. It shows the difficulty the local union has in trying to see whether their funds protected, the inability to get information from any Federal agency and the hesitancy involved.

Well, I thank the members of the panel very much for your testimony, and thank you.

Our next panel will be Richard Poole, William Kish, Edward Weiler, Jesse Day, and James Benages.

If you gentlemen will come forward. Richard Poole is a trial attorney, with the Fraud Section, Criminal Division, U.S. Department of Justice from Florida.

William Kish is a Senior Auditor at the Office of the Inspector General, U.S. Department of Labor from the Miami District. Edward Weiler is Director of the Employee Plans and Exempt Organizations Operations Division of the IRS. Jesse Day is a district supervisor in the Miami District Office, and James Benages is the area director of the Boston area office of the Pension and Welfare Benefits Administration.

We thank you, gentlemen, for coming, and all of your statements will be put in the record. And we are going to ask you now if you will please present your testimony in a concise manner.

We will call on first, Mr. Poole.

STATEMENT OF RICHARD POOLE, TRIAL ATTORNEY, FRAUD SECTION, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE (FORMER ASSISTANT U.S. ATTORNEY, MIDDLE DISTRICT OF FLORIDA)

Mr. Poole. Thank you, Mr. Chairman, and members of the subcommittee.

I am Richard Poole. I am pleased to be here today to discuss the prosecution of the Modern Dairy Farms case with you. I handled that case from grand jury through trial and appeal as an assistant U.S. attorney for the middle district of Florida.

Probably any prosecutor would relish the opportunity to come before this body to discuss a case that he tried and won. However, before I do, I should mention to you that I am not a spokesman for the Department of Justice on the policy issues you are going to be considering.

Chairman Pickle. You are not what?

Mr. Poole. I am not a policy witness, Mr. Chairman. I am here to discuss the case. Jack Keeney, I am sorry—Deputy Assistant Attorney General John Keeney will be here tomorrow to present the Department's policy views.

The Modern Dairy Farms case has been outlined for you by the staff. It involved an embezzlement by Herbert L. Freel of $770,500 from a pension fund maintained under the Modern Dairy Farms profit sharing plan. The plan was designed to provide for the retirement of the employees of a large dairy operation centered in Okeechobee, Fla., and was covered by the provisions of ERISA.

Freel depleted virtually all of the funds' assets. As a result of his actions, approximately 108 participants in the plan who were the barn-hands, field workers, office workers, and managers of the dairy, many of whom were at or near retirement age, were deprived of their retirement savings. Moreover, the plan was not insured by the Pension Benefit Guarantee Corporation. Prosecuting this case presented some complications which are common to major white collar crimes. The investigation required a study of ERISA's regulatory scheme, and the businesses which Freel was involved in. For example, as a part of this case, we sought to prove that the agricultural venture into which Freel poured the plan funds, a crop of Jerusalem artichokes, planted in a muck farm was excessively speculative.

Now, to prove that, we sought the assistance of a professor of agriculture, first of all, to explain what in the world are Jerusalem artichokes and muck farms, and then to assess the commercial viability of the venture.

Further, proving Herbert Freel's guilt in this case required that we show that he violated his fiduciary duties willfully, that is with bad purpose, either to disobey or disregard the law.

Now, Freel contended that his fiduciary breach was innocent and that ERISA's complexity led him to breach his duties unwittingly.

We proved instead that he did so willfully by means of a painstaking reconstruction of events spanning several years, which established a pattern of concealment of the loans, and by showing that several attorneys and a fellow trustee had advised him that similar transactions were illegal.

Mr. Chairman, one other factor about this case that makes it stand out above most of the other cases I had as a prosecutor is the breadth of suffering caused by Herbert Freel's crimes. Those 110 participants were just out; they lost their retirement funds, and a number of them were nearing retirement age.

We, at the sentencing hearing, notified some of the participants that Herbert Freel was going to be sentenced, and a group of them drove all night from Okeechobee, Fla., to Jacksonville for an 8 a.m. sentencing hearing, and three of them got to testify at the sentencing hearing.

I remember one fellow, a barn hand whose nickname was Peanut, Mr. Chairman. He had 3-inch wide suspenders and a wife named Lulabelle, who testified that he had been working in the barns nearly all his life, and he had worked for the company some 20 years, and he was going to retire that year, but he couldn't because the retirement money was gone.

So when you think about the potential consequences of these cases, I think it is important to remember the consequences that they had in this case.

Mr. Chairman, I have come prepared to answer the questions you posed in writing in your letter. If you wish, I will do so now. I have done so in writing in my statement, and I will also be pleased to entertain any other questions you have.

[The prepared statement follows:]

STATEMENT OF RICHARD POOLE, TRIAL ATTORNEY, FRAUD SECTION, U.S. DEPARTMENT OF JUSTICE

Mr. Chairman and Members of the Subcommittee, I am pleased to be here today to discuss the prosecution of the Modern Dairy Farms case. I handled this case, from grand jury through trial and appeal, as an Assistant United States Attorney for the Middle District of Florida. Probably any prosecutor would relish the opportunity to appear before a body such as this to discuss a case he tried and won. However, before I do, I should caution that I am not a spokesman for the Department of Justice on the policy matters you will be considering during these hearings, and any views which I express are strictly my own. Deputy Assistant Attorney General John C. Keeney will present the Department's views tomorrow.

My statement will be divided in two parts. The first will provide a synopsis of the Modern Dairy Farms case. The second will answer some specific questions which Chairman Pickle posed in his letter to Attorney General Richard L. Thornburgh on May 25, 1990.

Synopsis of Modern Dairy Farms Case

The Modern Dairy Farms case involved an embezzlement by Herbert L. Freel of $770,500 from a fund maintained under the Modern Dairy Farms and Its Related Employers Profit Sharing Plan (the Plan). The Plan was designed to provide for the retirement of the employees of a large dairy operation centered in Okeechobee, Florida, and was covered by the provisions of the Employee Retirement Income Security Act (ERISA). Freel depleted virtually all of the fund's assets. As a result, the approximately 108 participants in the plan, who were the barn hands, field workers, office workers and managers of the dairy, many of whom were at or near retirement age, were deprived of their retirement savings.

The evidence we produced at trial showed that Freel acquired the Charles McArthur Dairy Farms, Inc. and six subsidiaries in 1979. At that time, the corporation had assets estimated at $90 million, 350 employees, and 60 thousand dairy cows. It also had a pension plan worth approximately a million dollars.

Freel operated the dairy under the umbrella of his Modern Dairy Farms corporation, and folded the pre-existing McArthur Dairies pension plan into a newly created plan, the Modern Dairy Farms and Its Related Employers Profit Sharing Plan And Trust. Freel was the president and sole shareholder of the corporation and one of three trustees of the Plan.

On January 12, 1981, Charles McArthur Dairy Farms, by far the largest piece of Freel's operation, filed a petition under Chapter 11 of the bankruptcy code seeking protection from its creditors. At trial, we showed that prior to the bankruptcy Freel repeatedly asked corporate attorneys and co-trustees of the Plan whether he could borrow money from the Plan to bail out his failing corporation. These witnesses testified that they told Freel that such a loan was illegal, and that if he made such a loan, he would go to jail.

In July 1982, Freel, who by then was the sole trustee of the profit sharing plan, hired Charles Ian Nash, of Palm Bay, Florida, as the Plan's attorney. Attorney Nash advised Freel that due to the bankruptcy of the sponsoring company, the plan would have to be terminated and the assets liquidated and distributed to the participants. As sole trustee, Freel authorized Nash to proceed with termination. Nash also told Freel that the Plan funds should be maintained in a liquid state in preparation for the distribution.

Despite this advice, during the period of September 24, 1982, through January 26, 1984, Freel "loaned" $770,500, virtually all of the fund's assets, to two corporations nominally owned by his then- twenty six year old daughter. The government argued that "loan" transaction was in fact a sham designed to conceal the fact that Freel used the Plan as a slush fund to provide capital for a farming venture which he hoped would rescue him from his personal financial difficulties. However, the farming venture was unprofitable, and the money taken from the plan was consumed by expenses.

Moreover, while Freel was depleting the Plan assets, he concealed the loans from the Plan's attorney, its actuaries and accountants, and its participants. Attorney Nash sent notices regarding termination to plan participants, and filed with the IRS for approval of termination, all with Freel's concurrence. These mailings were to become the basis of the mail fraud charges against Freel.

After more than a year's delay, the plan's participants were making increasingly strident demands that the assets of the Plan be distributed. Finally, on March 9, 1984, after the Plan's accountant and attorney threatened to resign, Freel for the first time informed the attorney that he had "loaned" the money to his daughter's corporations. The attorney, Charles Ian Nash, promptly reported the transaction to the Department of Labor's Office of Pension and Welfare Benefits Administration.

The case was first presented to the office of the United States Attorney by Auditor William Kish of the Office of Pension and Welfare Benefits Administration on May 23, 1984. A grand jury investigation was opened on February 19, 1986. Herbert Freel was indicted on November 13, 1986, on charges of mail fraud, 18 U.S.C. 1341, and embezzlement from an ERISA fund, 18 U.S.C. 664, and was convicted at the conclusion of a one week trial on January 8, 1988. On January 28, 1988, after a sentencing hearing which included testimony by several of the Plan's participants, Freel was sentenced to four years of incarceration.

Neither Freel nor the corporations under his control was able to replace the lost funds. The Plan was not insured by the Pension Benefit Guarantee Corporation. In 1989 the Plan recovered $150 thousand in a claim against a fidelity bond, but after expenses, and allowing for interest, the fund will be able to pay out less than ten cents on the dollar.

Prosecuting the case presented many complexities common to major white collar crimes. The investigation required study of the ERISA regulatory scheme and the businesses in which Freel was engaged. For example, we sought to prove that the agricultural venture into which Freel poured the Plan funds -- a crop of jerusalem artichokes planted in a muck farm -- was excessively speculative. To do so we sought the assistance of a professor of Agriculture from the University of Florida, first to explain jerusalem artichokes and muck farms, and then to assess the commercial viability of the venture.

Further, showing Freel's guilt required that we show that he violated his fiduciary duties willfully, that is, with bad purpose either to disobey or disregard the law. Freel contended that his fiduciary breach was innocent, and that he was unaware that the "loans" were prohibited transactions. We proved willfulness by means of a painstaking reconstruction of events spanning several years which established a pattern of concealment of the loans.

Finally, because Freel defended against the charges by claiming that ERISA's complexity led him into an unwitting breach, we also had to persuade the jury that his violation was so obvious and blatant that he knew beyond a reasonable doubt that his actions were wrong. We did so by showing that several attorneys and a fellow trustee advised that similar transactions were illegal, and that he concealed the loans from the participants and Plan attorney for 16 months.

Responses to Questions Posed by Chairman Pickle

In his letter of May 25, 1990, Chairman Pickle posed four questions. His questions and my responses follow:

1. Why was the case prosecuted?

Several factors were important. First, the loss to the victims - the plan participants - was very substantial. Second, the investigation uncovered persuasive evidence that Freel violated his fiduciary obligations knowingly and willfully after contrary advice from counsel. Finally, the case could not have been prosecuted without the skill and hard work of Auditor William Kish of the Pension and Welfare Benefits Administration.

2. How much time was spent on the case?

In all, I estimate that I spent approximately six months of work time, spread over the period between June 1985 and February 1989.

3. What did you actually do to prosecute the case?

The following list sets forth the major milestones in the life of the prosecution. The list of course omits many meetings with Auditor Kish, witness interviews, phone calls, legal research, motions and responses, and trial preparation.

May 23, 1984	Initial presentation of case by Auditor William Kish, and PWBA supervisors Jesse Day and James Batterbury.
June 17, 1985	Meeting with Auditor Kish regarding commencement of criminal investigation.
February 1986	Grand Jury.
March 1986	Grand Jury.
April 4, 1986	Received and reviewed Report of Investigation.
July 2, 1986	Received and reviewed Supplementary Report of Investigation.
July 1986	Grand Jury.
October 1986	Grand Jury.
November 13, 1986	Grand Jury returns 14 count indictment against Herbert L. Freel.
January 4, 1988	Trial begins. Court announces that government will be permitted to try case on only 7 counts to reduce trial time. The other 7 counts were "held in abeyance."

January 8, 1988	Freel convicted by jury on 7 counts.
January 28, 1988	Sentencing hearing. Testimony by three beneficiaries of Plan.
March 9, 1988	Notice of Appeal filed by defendant.
September 30, 1988	Government's appeal brief filed at Eleventh Circuit Court of Appeals.
January 23, 1989	Oral argument on appeal.
February 24, 1989	Judgment of conviction affirmed.

4. What were the results of the prosecution?

Herbert Freel received a sentence of four years of incarceration. He is scheduled to be released to a halfway house in June of 1990. The court entered a restitution order for $770,500. No money has been recovered through restitution because Freel has no known assets to satisfy the order.

Chairman PICKLE. Mr. Poole, I thank you.

We will proceed with the other witnesses and then open it up for all the questions.

Thank you very much.

Now, we will hear from William Kish, auditor of the inspector general's office.

Mr. Kish.

STATEMENT OF WILLIAM D. KISH, SENIOR AUDITOR, OFFICE OF THE INSPECTOR GENERAL, OFFICE OF PROGRAM FRAUD AUDITS, U.S. DEPARTMENT OF LABOR (FORMER INVESTIGATOR, MIAMI DISTRICT OFFICE, PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR)

Mr. KISH. Mr. Chairman and members of the subcommittee, my name is William Kish. I have been an auditor with the U.S. Department of Labor since 1978. Currently, I am a senior auditor with the DOL, Office of the Inspector General, Office of Program Fraud Audits here in Washington, D.C.

Chairman PICKLE. Mr. Kish, would you pull the microphone closer to you and speak a little louder.

Mr. KISH. I have been an auditor for the U.S. Department of Labor since 1978.

Chairman PICKLE. I still can't hear you well enough, Mr. Kish.

Mr. KISH. I have been an auditor with the U.S. Department of Labor since 1978. Currently, I am a senior auditor with the Department of Labor, Office of Inspector General, Office of Program Fraud Audits here in Washington, D.C.

At the time I investigated the criminal case known as *U.S.* v. *Herbert Freel,* I was an auditor in the Miami District Office of PWBA. I am appearing before this committee on behalf of my former employer, PWBA.

This case was opened on April 2, 1984, based upon information contained in the Modern Dairy Farms profit sharing plan civil case, which revealed possible criminal violations of title 18, section 664, embezzlement. At this time, a delegation of authority was obtained from the U.S. Justice Department, and Assistant U.S. Attorney Richard Allen Poole was assigned to litigate this case. On April 20, 1984, a memorandum was received from the regional solicitor's office in Atlanta requesting a delay of 2 weeks in the criminal field work to allow time to secure an agreement on a civil judgment. On May 14, 1984, another extension was requested. On May 23, 1984, Supervisor Jesse Day and Auditor James Batterbury, and myself met with Mr. Poole in Jacksonville, Fla. Due to the concurrent civil case, the field work did not commence until June 1985. On February 19 and March 19, 1986, I testified before the grand jury. On April 4, 1986, a report of investigation was submitted to Mr. Poole. Between February 1986 and November 12, 1986, 12 other witnesses testified before the grand jury. On November 13, 1986, Mr. Freel was indicted. Subsequently, over 30 witnesses were extensively interviewed prior to trial.

Mr. Freel was convicted after a jury trial during the week of January 4 through January 8, 1988, on charges of embezzling $770,500 from the Modern Dairy Farms profit sharing plan. On

January 8, 1988, Mr. Freel was convicted of six mail fraud counts and one embezzlement count. On January 28, 1988, he was sentenced to 4 years of incarceration and ordered to make restitution in the amount of $770,500. This case took approximately 202 staff days and spanned just under a 4-year period of time.

Thank you, Mr. Chairman. I will be happy to answer any questions you or the members of the subcommittee may have.

[The prepared statement follows:]

PWBA TESTIMONY BY
WILLIAM D. KISH
REGARDING MODERN DAIRY CRIMINAL INVESTIGATION
FOR WAYS AND MEANS SUBCOMMITTEE HEARING

Mr. Chairman and Members of the Subcommittee, my name is William D. Kish. I have been an Auditor with the United States Department of Labor (DOL) since 1978. Currently I am a Senior Auditor with DOL, Office of Inspector General (OIG), Office of Program Fraud Audits here in Washington, D.C. At the time I investigated the criminal case known as U.S. v. Herbert Freel, I was an auditor in the Miami District Office of the Pension and Welfare Benefits Administration. I am appearing before this committee on behalf of my former employer, PWBA.

This case was opened on April 2, 1984, based upon the information contained in the Modern Dairy Farms Profit Sharing Plan civil case which revealed possible criminal violations of Title 18 Section 664 -- Embezzlement. At this time a Delegation of Authority was obtained from the U.S. Justice Department and Assistant United States Attorney (AUSA) Richard Alan Pool was assigned to litigate this case. On April 20, 1984, a memorandum was received from the Regional Solicitor's Office in Atlanta requesting a delay of two weeks in the criminal field work to allow time to secure an agreement on the civil judgement. On May 14, 1984 another extension was requested. On May 23, 1984, Supervisor Jesse Day and Auditor James Batterbury and I met with AUSA Poole in Jacksonville, Florida. Due to the concurrent civil case, the field work did not commence until June 1985. On

February 19, 1986 and March 19, 1986, I testified before the Grand Jury. On April 4, 1986, a report of investigation was submitted to AUSA Poole. Between February 1986 and November 12, 1986 twelve other witnesses testified before the Grand Jury. On November 13, 1986, Mr. Freel was indicted. Subsequently over 30 witnesses were extensively interviewed prior to trial.

Mr. Freel was convicted after a jury trial during the week of January 4 through 8, 1988, on charges of embezzling $770,500.00 from the Modern Dairy Farms Profit Sharing Plan. On January 8, 1988, Mr. Freel was convicted of the six mail fraud counts and one embezzlement count. On January 28, 1988, he was sentenced to four years of incarceration and ordered to make restitution in the amount of $770,500. This case took 202 staff days and spanned just under a 4 year period of time.

The evidence at trial established that defendant Freel acquired the Charles McArthur Dairy Farms, Inc. and its six subsidiaries in 1979. The corporation at that time had estimated assets of $90 million, an estimated net worth of $20 million, 350 employees, and owned or leased 60,000 dairy cows. Mr. Freel was the sole corporate shareholder. Mr. Freel was also one of three trustees of the corporation's profit sharing plan.

On January 12, 1981, Charles McArthur Dairy Farms, Inc. filed a petition under Chapter 11 of the bankruptcy code seeking protection from its creditors. At the trial the United States established that prior to the bankruptcy, Mr. Freel repeatedly asked corporate attorneys and co-trustees of the Modern Dairy Farms Profit Sharing Plan whether he could borrow money from the Plan to bail out his failing corporation. At that trial, these witnesses testified that they told defendant Freel that such a loan was illegal, and that if he made such a loan, he would go to jail.

In July 1982, Mr. Freel, who was by then the sole trustee of the Modern Dairy Farms Profit Sharing Plan, hired Charles Ian Nash of Palm Bay, Florida as Plan attorney. Attorney Nash advised him that, due to the bankruptcy of the sponsoring company, McArthur Dairies, the Plan would have to be terminated and the assets liquidated and distributed to the participants. As sole trustee, Mr. Freel authorized Nash to proceed with the steps necessary for termination. Nash advised Mr. Freel that the profit sharing's plan funds should be maintained in a liquid state in preparation for the distribution.

Despite the advice of his attorney, during the period September 24, 1982 through January 26, 1984, Mr. Freel systematically depleted the plan's funds in the amount of $770,500.00. The money was "loaned" to Transworld Farming, Inc. and Transworld Foods, Inc., corporations nominally owned by Dana L. Freel, the defendant's then -- 26 year old daughter. The United States contended that Mr. Freel used the Modern Dairy Farms Profit Sharing Plan as a "slush fund" to provide capital for a farming venture which he hoped would rescue him from his personal financial difficulties. However, the money was virtually all lost in unprofitable farming ventures.

During the period in which Mr. Freel was depleting the Plan's assets, he concealed the loans from the Plan's attorney, its actuaries and accountants, and its participants. In early 1983, with Mr. Freel's approval, Nash sent the participants' a notice of proposed termination. In November 1983, after receiving IRS approval of the termination, Mr. Freel authorized Nash to send a "Notice of Election to Plan Participants" offering them the election to have income tax withheld from the distribution of Plan assets. The United States established that these mailings concealed the fraud from Plan participants, who were led to believe that a distribution was imminent. By the time the Notice of Election was mailed by Mr. Freel he had already withdrawn $668,500 from the Plan, the bulk of its assets.

Mr. Freel finally disclosed the loans to the Plan's attorney on March 9, 1984, after numerous demands from Plan participants and resignation threats from the Plan's accountant and attorney. The Plan's attorney then promptly reported the transaction to the Department of Labor.

Thank you Mr. Chairman, I'll be happy to answer any questions you or other members of the subcommittee may have.

Chairman **Pickle**. I am sure we will have questions, Mr. Kish, and we thank you.

Now, we will ask Edward Weiler, the Director of the EPEO, representative of the Internal Revenue Service.

Mr. Weiler.

STATEMENT OF EDWARD J. WEILER, DIRECTOR, EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS OPERATIONS DIVISION, INTERNAL REVENUE SERVICE

Mr. **Weiler**. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, my name is Edward Weiler and I am the Director of the EPEO Operations Division, Internal Revenue Service here in Washington, D.C.

I am here today to discuss the case of Modern Dairy Farms Inc.

This case involved a series of prohibited transactions under section 4975 of the Internal Revenue Code. Herbert Freel was the sole shareholder of Modern Dairy Farms Inc. Modern Dairy Farms was the sponsor of a profit sharing plan which was qualified under section 401(a) of the Internal Revenue Code. Mr. Freel was the trustee of the plan.

It was in that capacity that Mr. Freel made two loans totaling $770,500 to two related corporations. Mr. Freel as trustee and sole shareholder of Modern Dairy Farms is a disqualified person under section 4975 of the code.

The corporations were also disqualified persons. Both loans constituted prohibited transactions.

As a result of an investigation conducted by the Department of Labor, this case was referred to the Internal Revenue Service, in accordance with the IRS coordinated compliance agreement.

Upon receipt of the referral, our Atlanta District Office assigned the case to an Internal Revenue field agent for review. The revenue agent reviewed the case file and the referral for completeness and determined that sufficient information existed to assess excise taxes under the Internal Revenue Code, section 4975, without requiring an on-site audit. The revenue agent proposed the assessment of excise taxes in the amount of $850,550 for plan years 8306, 8406, and 8506 in July of 1986.

The revenue agent's proposed assessments were subsequently approved by the Atlanta key district quality review staff and the Southeast Regional Payrolls Office of the Internal Revenue Service. The tax assessment notices were issued by the Atlanta service center in August of 1988.

This concludes my testimony at this time, Mr. Chairman. I will be happy to answer any questions that you or members of the committee shall ask.

Chairman **Pickle**. Thank you, Mr. Weiler.

Now, we have Mr. Jesse Day, the district supervisor of the Miami office.

STATEMENT OF JESSE L.V. DAY, DISTRICT SUPERVISOR, MIAMI DISTRICT OFFICE, PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. DAY. Mr. Chairman and members of the subcommittee, my name is Jesse Day. I am the district supervisor in the Pension and Welfare Benefits Administration's Miami district office, which has jurisdiction over private employee benefit plans located in the State of Florida and the Commonwealth of Puerto Rico.

I am pleased to be here today to testify regarding my office's civil investigation of the Modern Dairy Farms profit sharing plan. You have already heard the testimony of Mr. Kish, a former PWBA investigator who conducted the Pension and Welfare Benefits Administration's criminal investigation of the Modern Dairy Farms plan. I will limit my remarks to our civil investigation.

The civil investigation of the Modern Dairy Farms profit sharing plan was opened on March 21, 1984, as a result of information received by the Miami District office from the plan's attorney, Charles Ian Nash, of Melbourne, Fla. Mr. Nash had been providing legal services in connection with the proposed termination of the plan. On March 19, 1984, Mr. Nash met with me and Auditor Lizabeth Fortner of the Miami district office and informed us that he had learned that Herbert Freel, the plan's trustee, had loaned $770,500 from the plan. At the time, I was a group supervisor and investigator in the Miami office.

On March 22, 1984, Investigator Robert Passero and Auditor Liz Fortner met with the plan's auditor, Kay Williford of W.O. Daly & Co. of Orlando, Fla. Mr. Williford was interviewed and several cartons of plan records were obtained. On March 23, 1984, Trustee Freel was extensively interviewed and all original books and records of the plan were obtained. During the period of March 26, 1984, through March 30, 1984, an indepth analysis of plan records was conducted which revealed that Mr. Freel had loaned $677,500 to Transworld Food, Inc., and $93,000 to Transworld Farms, Inc., during the period of September 1982 to January 1984. At the time the loans were made, Mr. Freel was president of both corporations and his 26-year-old daughter was the sole stockholder. The loans represented approximately 75 percent of total plan assets. There were approximately 153 participants in the plan at the time the loans were made.

A report of investigation was prepared by the Miami district office and referred to the Atlanta regional office on March 30, 1984. On April 2, 1984, a criminal investigation was opened by the Miami office to investigate potential criminal violations. The Atlanta regional office referred the civil case to the Department's regional solicitor's office in Atlanta for litigation on April 20, 1984. On October 2, 1984, the Department filed suit against Mr. Freel for fiduciary violations of ERISA resulting from the prohibited loans.

On October 9,1984, a consent order was entered in the Federal court in Orlando, Fla., removing Mr. Freel as trustee and requiring him to repay $770,500 plus $114,716 in interest to the plan. The consent order stipulated that Mr. Freel was to repay the plan in a series of installments. No payments have ever been made. In March 1986, the Miami district office contacted the IRS, the U.S.

Customs Service, the Division of Corporate Records of the Florida Secretary of State, and other sources in an effort to assist the Department's regional solicitor in locating any hidden assets of Trustee Freel, his family, or corporations in which he had an interest in order to satisfy the judgment. No assets were found.

On March 25, 1985, the Miami district office made a referral to the IRS. After close coordination regarding timing, the IRS imposed an $850,000 excise tax on or about July 21, 1986.

The case was closed on March 19, 1989, upon the plan's receipt of a $150,000 settlement from the plan's bonding company, Ohio Casuality Insurance Co., on its fidelity bond. The Miami district office had provided assistance to the plan's attorney, acting on behalf of the plan's participants, in pursuing litigation to enforce the bonding claim on the plan's fidelity policy which insured losses up to $100,000 against the Ohio Casuality Insurance Co. Since the embezzlements, in the criminal case, had occurred over a period of several years, a multiple of the $100,000 coverage was sought by the plan's attorney. After negotiation, the parties agreed to settle the claim for $150,000.

The present trustee, Barnett Bank Trust Co., Jacksonville, will reportedly make a final distribution of the plan's assets, which total approximately $237,000, to participants on or before September 30, 1990. The total investigative time charged to this case was 45 staff days. This includes litigation support.

Thank you, Mr. Chairman. I will be happy to answer any questions you or other members of the subcommittee may have.

Chairman PICKLE. Mr. Day, did your testimony include a statement regarding the Visual Scene investigation? Did you have two statements to make?

Mr. DAY. Yes, sir, I do. That is another case. I am ready to testify with respect to that case if you are ready for it. I am presenting two cases, sir.

Chairman PICKLE. Have you made your statement with respect to Visual Scene?

Mr. DAY. No, I have not; not yet.

Chairman PICKLE. Well, now be the appropriate time to do that. Mr. Benages, if you will proceed.

STATEMENT OF JAMES M. BENAGES, AREA DIRECTOR, BOSTON AREA OFFICE, PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. BENAGES. Mr. Chairman and members of the committee, my name is James Benages. I am the director of the Boston office of the Pension and Welfare Benefits Administration, which has jurisdiction over the six New England States and upstate New York.

I am pleased to be here today to discuss our civil investigation of the Plumbers and Steamfitters Local Union Pension Fund. The investigation of the Plumbers and Steamfitters Local Union 131 pension plan was opened on November 9, 1982, as a result of information regarding the plan's participation in a loan to the Merrimack Street Baptist Church. The Boston area office had obtained the information in investigations it had previously conducted of the

Northern New England Carpenters and the New Hampshire Bricklayers pension funds.

The investigation began on December 15, 1982, with a review of the accounting records of the plan's accountant. On January 19, 1983, the plan administrator, on advice of legal counsel, denied the investigator access to plan records. The Department issued a subpoena for the records on March 3, 1983.

When the trustees failed to comply with the subpoena, the Department instituted a subpoena enforcement action to compel the production of the documents on June 8, 1983. The court granted the Department's petition to compel production of documents on March 30, 1984, and the investigation resumed. While the Department's subpoena enforcement action was progressing, two additional plan investments which appeared questionable were uncovered. These investments, of $1.5 million in a certificate of deposit and a $1.2 million loan to a real estate developer, also required investigation.

The investigation revealed that the plan invested $1.5 million in a New Hampshire savings bank certificate of deposit at 9 percent with a 3-year term. This certificate was purchased to facilitate a construction loan to Michael Ingram, who was to proceed with a union-built project. The investigation disclosed that the interest rate on the CD was set to match the developer's construction loan interest rate. This construction loan rate, minus the 2 to 3 percent the New Hampshire Savings Bank required as its income, resulted in a CD rate of 9 percent. The bank was offering CD's to other depositors at a rate of 11.5 percent.

The investigation further revealed that the plan's investment in the $1.2 million loan, which also carried a below-market interest rate, was made to the real estate developer subject to the understanding that only union labor would be used in the building project.

A "Report of Investigation" prepared by the Boston area office was referred to the national office on October 9, 1986. The investigation was referred for litigation to the Office of the Solicitor of Labor on February 27, 1987.

On August 7, 1987, the Department filed suit in the U.S. District Court for the district of New Hampshire against nine plan trustees, the plan administrator, and the savings bank which held the certificate of deposit.

The complaint alleged violations of the fiduciary provisions of ERISA, resulting from the plan's investment of $1.5 million in a CD at a below-market interest rate in order to facilitate a loan to a third party for a construction project where only union labor would be used. The complaint was later amended to include allegations of ERISA violations resulting from the loan by the plan of $1.2 million at a below-market interest rate to a developer who agreed in return for the loan to use exclusively union labor on a real estate building project.

On January 6, 1989, a consent order was entered requiring the trustees to retain an investment manager for a period of 10 years to make all investment decisions for the plan, prohibiting the plan administrator from exercising authority or control over the management and investment of plan assets of any plan governed by

ERISA, and requiring that any future investment of plan assets in federally insured CD' and real estate construction loans be first approved by an independent fiduciary.

The court also ordered the defendants to make restitution to the plan of $107,000. The total investigative time charged to this case was 146 staff days.

During the course of the civil investigation, the possibility of also proceeding criminally was considered. However, we did not believe that these below-market interest rate investments stipulating the use of union labor in real estate development projects rose to the level of a criminal violation.

The trustees' intent was to invest in projects that would employ union members and although it was to the detriment of the plan, it did not inure to the benefit of anyone. It was detrimental to the plan in that the investment was made at below-market rates and that issue was fully addressed in our civil case.

Thank you, Mr. Chairman. I will be happy to answer any questions you or other members of the subcommittee may have.

Chairman PICKLE. I thank you.

Now, Mr. Day, I am going to first ask you to insert your statement on Visual Scene case for the record. We have a copy, but let's at this point put it in the record. Is that satisfactory to you, because the committee may have some questions we want to ask you as we go along.

Mr. DAY. Yes, sir.

[The statement follows:]

PWBA TESTIMONY BY
JESSE DAY
REGARDING VISUAL SCENE INVESTIGATION
FOR WAYS AND MEANS SUBCOMMITTEE HEARING

Mr. Chairman and Members of the Subcommittee, my name is Jesse L. V. Day. I am the District Supervisor in the Pension and Welfare Benefits Administration's Miami District Office, which has jurisdiction over private employee benefit plans located in the state of Florida and the Commonwealth of Puerto Rico.

I am pleased to be here today to testify regarding my office's civil investigation of the Visual Scene, Inc. Profit Sharing Plan.

The investigation was opened on December 27, 1984, to probe for violations of ERISA. The Miami District Office's files included complaints from participants that benefit payouts were being delayed. The commencement of the investigation was scheduled for January 7, 1985, but was delayed three times at the separate request of the Plan's attorney, a Plan trustee, and the Plan's accountant. All stated that they needed additional time to compile records. A limited review investigation began on August 1, 1985, when investigator Don Trimas met with corporate officials of Visual Scene, Inc., their attorney, and the Plan consultant. Twelve days later, on August 13, 1985, the investigation was converted to a broader scope fiduciary investigation based on the finding of possible prohibited loans.

During the course of the investigation, Investigator Trimas performed an extensive examination of the Plan's books and records and interviewed Plan trustees Peter Patraka and Myron Orlinsky and other Plan officials. The investigation revealed that the Plan made a series of prohibited loans to Mr. Patraka and Mr. Orlinsky from November 1979 to December 1981. On November 20, 1979, the plan loaned Mr. Patraka and Mr. Orlinsky

$150,000 each. The executed loan notes required the repayment of the loans plus interest by June 30, 1980. On December 11, 1979, Mr. Patraka received an additional loan of $42,000, to be repaid under the terms of the note with interest by June 30, 1980. On December 11, 1981, Mr. Orlinsky and Mr. Patraka each borrowed an additional $50,000 with the notes setting a repayment date, including interest, by December 10, 1986. As of December 11, 1981, the total loans outstanding were $242,000 to Mr. Patraka and $200,000 to Mr. Orlinsky. No substantive repayment or attempts at collection had been made to the Plan at the time of the investigation. The loans, representing approximately 95% of total plan assets, were inadequately secured, habitually extended, and resulted in the Plan's inability to pay benefits when due because of insufficient liquidity. Accruing interest had substantially increased the balance outstanding on the loans to $671.291 by February 28, 1986. In an interview conducted by Investigator Trimas, Mr. Patraka and Mr. Orlinsky indicated that Visual Scene, Inc. had been experiencing financial difficulties which necessitated the borrowing of funds from the Plan, funds which they had re-invested in the corporation.

On April 10, 1986, the Atlanta Area Office sent a demand letter to Mr. Orlinsky and Mr. Patraka, the Plan's trustees, citing them with violations of the fiduciary provisions of ERISA resulting from the trustees receipt of the prohibited loans. The letter also requested them to immediately repay all outstanding loan balances, including interest, to the Plan and that the Plan pay out benefits to the terminated Plan participants. Following the issuance of this letter, the trustees' attorneys contacted the Miami District Office on several occasions, representing that they intended to repay the loans to the Plan but needed more time to make the repayment. On two of these occasions the trustees agreed to establish repayment plans. In their first proposal, submitted in writing shortly after the initial face to face discussions in the District Office on July 16, 1986, they indicated a willingness to voluntarily correct all violations.

They represented that the company was having a good year financially and that a trial date in late 1986 or early 1987 was expected in a major lawsuit filed by Mssrs. Patraka and Orlinsky, against Pilkington Brothers, a lawsuit they expected to win and in which compensatory damages alone would be in excess of $20 million. The trustees had provided signed statements to the Miami District Office that their obligations to the Plan would be immediately repaid once the lawsuit was settled. Further they agreed to send monthly financial reports showing the company's financial condition, the financial statements of both trustees, and restore $20,000 per month to the Plan. In a later proposal they reduced the restoration amount to $5,000 per month. The trustees never followed through in any substantive manner on these proposals and by December 1987, the Miami District Office and Atlanta Area Office had determined that the referral of the case to the Department's Regional Solicitor's Office in Atlanta for the initiation of litigation was necessary.

A Report of Investigation, prepared by Investigator Trimas, was referred to the Atlanta Area Office on December 15, 1987. On January 20, 1988, the matter was referred by the Atlanta Area Office to the Department's Regional Solicitor, for litigation. On December 6, 1988, the Department filed suit against Mr. Patraka and Mr. Orlinsky. On March 9, 1989, a consent order was entered in the U.S. District Court for the Southern District of Florida, requiring the trustees to restore approximately $800,000 to the Plan, including interest, as restitution for the improper loans made by the Plan to themselves.

As a result of the civil action filed by the Department, the trustees waived their own interests in their individual Plan accounts and restored approximately $250,000 to the Plan which was sufficient to satisfy the benefit payouts due Plan participants, other than those who were Plan trustees or relatives of the trustees. Several participants, due a total of

$3,483, have not been located and have received no distribution to date. These funds are currently held in a trust account maintained by the Plan's attorney. All other participants who were due benefits, excluding the trustees and their relatives as noted above, received their distributions by May 1989. This case was closed on October 25, 1989, upon confirmation that participants who were due a distribution from the Plan, excluding those Plan participants who were Plan trustees or relatives of the trustees, were paid in full. Total staff days charged to the case were 60.

On March 28, 1986, the Miami District Office referred information relating to the unpaid loans to the Internal Revenue Service for the imposition by the IRS of an excise tax on the prohibited transactions. The IRS informed us that the referral would he held in suspense until such time as the IRS field office Employee Plans Division resources permitted working the case. The Miami District Office re-referred the matter to the IRS on June 8, 1987, and sent additional information on July 24, 1987. In February 1990, IRS assessed an excise tax of $22,213 as a result of these violations.

Thank you, Mr. Chairman. I'll be happy to answer any questions you or other members of the Subcommittee may have.

Chairman PICKLE. Now, let me see.

Mr. Poole, you should know the difference between how some of these ERISA cases compare with other types of criminal cases.

Have you prosecuted any other white collar cases?

Mr. POOLE. Yes, sir, Mr. Chairman, I have.

Chairman PICKLE. You have?

Mr. POOLE. I have. I am presently with a unit of the Department of Justice that prosecutes defense procurement fraud cases. I have also done tax cases. I have also done other types of embezzlements, so I have some experience in white collar crime.

Chairman PICKLE. Well, how does this case compare to other types of cases that you investigate?

Mr. POOLE. Well, it has——

Chairman PICKLE. Is this type of case harder to get convictions on than, say, a drug case?

Mr. POOLE. Well, it depends on the drug case, but basically, yes. I mean there are large, complex drug cases, but most are more simple. Most drug cases you have drugs on the table and a defendant who was found in possession. And compared to a white collar case, that is an easy case.

Now, this case was time consuming and complicated. It is similar, I think, to the cases that my colleagues in the Bank Fraud Task Force are doing down in Dallas. It is a case where you have a complicated regulatory scene; you've got a fiduciary who has committed a fiduciary breach, and the question is what is it that makes that fiduciary breach a crime? And that is willfulness. And proving willfulness or intent is always the difficult thing in these cases.

Chairman PICKLE. Well, did you ever attempt to plea bargain with Mr. Freel?

Mr. POOLE. Well, we sure did, but it never resulted in a bargain that the Government and Mr. Freel would both accept.

Chairman PICKLE. Well, what did you offer Mr. Freel?

Mr. POOLE. A plea to a felony.

Chairman PICKLE. I beg your pardon?

Mr. POOLE. A plea to a felony, and he found that unacceptable.

Chairman PICKLE. Now, do you feel that if Mr. Freel had repaid the plan, that there would ever have been any criminal action at all?

Mr. POOLE. Well, Mr. Chairman, that is a decision we never had to make. It is possible that if he had paid the money up front, it never would have been investigated.

If it was presented to us, it is possible that the decision by our office would have gone the other way, but that was never presented to us, so I can't say for sure.

Chairman PICKLE. Well, I am going to ask Mr. Kish at this point, I guess I would ask you why was the criminal investigation opened after the civil action had taken place?

Mr. KISH. Well, what happened was once there was a review of the civil case, when the facts came in, the evidence from that civil case showed that there were badges of fraud, and that Mr. Freel knowingly and willingly converted these funds for his own use, therefore, a criminal case was opened.

Chairman PICKLE. Well, the PWBA civil action case had been completed at that point. Now——

Mr. Kish. No, sir.

Mr. Anthony. He said no?

Mr. Kish. It was not completed at that time.

Chairman Pickle. Well, do you believe that the criminal case would have been opened if the civil case had been successful in recovering the plan's assets?

Mr. Kish. Well, sir, that would have been a management decision. At my level, I would have no idea.

Chairman Pickle. Well, as you proceeded, did you find the form 5500 helpful to you?

Mr. Kish. Absolutely not. The form 5500 shows the financial statements, but on that particular form, there was no indication of fraud whatsoever.

Chairman Pickle. Well, I am sorry. I have having trouble hearing you, so I am going to ask you again.

Was the 5500 form used by you, was it helpful? Do we need to do more action or correction on the 5500 case form?

Mr. Kish. The form 5500 was not helpful.

Chairman Pickle. Was not?

Mr. Kish. Was not. It shows a financial statement, but it did not indicate whatsoever that any fraud had been committed. The form 5500 has certain blocks on it to mark if there is a prohibited transaction or other transactions that violate the law. In this particular case, there was a fiscal year that ended June 30, and the prohibited transaction had not been made at that point in time.

The fiscal year 1983 return had not been filed, thus, we did not have a copy of that particular return.

Chairman Pickle. Well, in your case, Mr. Day, were you ever successful at recovering any assets for the plan? How much were recovered? I am talking about the Modern Dairy Farms case.

Mr. Day. Right.

The only recovery in Modern Dairy would have been from action taken by the plan's attorney after the criminal case ran its course and Mr. Freel was convicted. There was a $100,000 bond existing. The attorney attempted to collect three times that bond amount based on the fact that the embezzlement occurred beginning in 1982 through 1984. He lost in court and they were to pay $100,000.

On appeal, or when they were going for appeal, both sides settled for $150,000.

Chairman Pickle. So, what was actually recovered? About $100,000?

Mr. Day. No, sir; $150,000.

Chairman Pickle. And that was the total recovery?

Mr. Day. Yes, sir; the plan's attorney recovered $150,000. There was some money left in the plan, and as I understand, there is about $237,000 held by Barnett Bank that will be distributed sometime this year.

Chairman Pickle. All right.

Well, did you find the 5500 form useful and helpful to you?

Mr. Day. Well, first of all, sir, on the 5500's filed in this case, the 1979 through the 1982, there were no loans, no party in interest transactions listed on the returns. Of course, Mr. Freel didn't begin to take the money until July of 1982, and the form was filed on a June 30 annual basis. Therefore, the 1983 return never was filed as far as I know, and that would have been the return that would have included maybe some information which would have led us to this case.

Chairman PICKLE. Well, you had filed a statement now on Visual Scene, and I want to ask you a question or two about the Visual Scene case.

What attempt did you make to recover the plan's assets before recommending that a civil suit be filed?

Mr. DAY. I was not the area administrator at the time. I wouldn't have made the decision, but I believe it fell within our voluntary compliance guidelines of a case that could be resolved on a local basis rather than using our scarce litigation resources.

The case involved issues amounting to around $500,000. The trustees were willing to make some kind of restitution to the plan, and that is why we proceeded with voluntary compliance in this case.

Chairman PICKLE. You were requesting voluntary compliance?

Mr. DAY. Yes, sir. We pursued voluntary compliance for probably a little too long, with hindsight.

Chairman PICKLE. How long did you attempt to collect those assets, that is through voluntary compliance?

Mr. DAY. About a year and a half.

Chairman PICKLE. A year and a half, plus. Why did you take so long to do that?

Mr. DAY. Sir, we had had attempted to get at the financial statements of Mr. Patraka and Mr. Orlinsky. We had attempted to get at corporate records, which would indicate the financial condition of the company. There were indications the trustees would pay. They had put schemes before us whereby they would make restitution to the plan.

As it turned out, they never followed through on their proposals, and we weren't able to do what we wanted to through voluntary compliance. Eventually the case got to the point where we said, well, this case needs to be referred to lock these individuals into the repayment schedule through court order.

Chairman PICKLE. Well, I have to assume that if you waited 1½ or 2 years to take any action, waiting for voluntary compliance, that you either had some reason to believe that fines would be paid, or else you didn't have enough staff.

Did you have full personnel there to proceed?

Mr. DAY. Yes, sir. We have a full staff, but you have to understand that an investigator can work about 10 cases a year, and we will do about 80 cases or so with the 8 staff members we have in the Miami district office.

So, whenever a case comes on board to be worked, oftentimes you can't work it at that point in time. You have to wait until you have——

Chairman PICKLE. Did you ever contemplate opening a criminal case against these two individuals, Patraka or Orlinsky?

Mr. DAY. The determination for that, or the decision would have been made by the area administrator at the time. In looking back at the file myself, sir, I don't believe that we found anything in this case, unlike the Modern Dairy Farms case, that would lead us to believe that we had criminal intent. There were notes. There was interest on loans. The loans were secured.

Chairman PICKLE. You say that because they repaid the loan, you just dismissed any kind of criminal action.

Mr. DAY. No, sir, because they did not repay the loans.

Chairman PICKLE. They did not?

Mr. DAY. They did not repay the loans.

Chairman PICKLE. All right.

I thank you.

Now, Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

May sure I understand who worked on what case.

Mr. Kish, you were working on the Modern Dairy case?

Mr. KISH. That is correct.

Mr. ANTHONY. You did not work on Visual.

Mr. KISH. That is correct, did not work on Visual Scene.

Mr. ANTHONY. You did not?

Mr. KISH. Did not.

Mr. ANTHONY. And, Mr. Day, you were the supervisor over at Modern Dairy?

Mr. DAY. Yes, sir. I initially went out and interviewed Mr. Nash, which led to the civil case and we knew on the day that we interviewed that we had badges of fraud.

Two weeks later we submitted the action report of investigation for the civil investigation on March 30. We had completed our investigation of the civil case for forwarding to the regional solicitors. That didn't mean the case was finished, because it took a while to litigate.

I was then, during the month of April, assigned to supervise Mr. Kish on the criminal case. I was his supervisor while he conducted the criminal investigation, although in reality, the case was turned over to Mr. Poole who did most of the supervision of Mr. Kish directly.

Mr. ANTHONY. Did you have any supervision on the Visual case?

Mr. DAY. I believe I was the supervisor and then later the district supervisor, and as district supervisor, I directly supervised all the staff.

The PW scheme——

Mr. ANTHONY. So let me make sure I understand where you were at that stage.

So once you were elevated to district director, that did put the responsibility for the Visual case decisions under your guidance?

Mr. DAY. Yes, sir.

Mr. ANTHONY. Did you exercise any jurisdiction or any responsibility in that case once you were named the director?

Mr. DAY. Yes, sir. I had face-to-face meetings with the trustees.

Mr. ANTHONY. Then you were involved in both of the cases.

Mr. DAY. Both cases, yes, sir.

Mr. ANTHONY. Voluntary compliance, did you attempt voluntary compliance, and if not, why not?

Mr. DAY. No, sir. There was an area administrator at the time. Remember, I was a supervisor at the time and the structure of the office changed within the period of time of these two cases. I was a group supervisor, supervising individuals like Mr. Kish at the time we were in turn supervised by an area administrator.

Now there is no area administrator position; there is a district supervisor position. I became the district supervisor when the administrator, Mr. Withers retired.

Can you repeat your question?

Mr. ANTHONY. It was a simple, straightforward question. You did undertake voluntary compliance and negotiations for a year and a half in the Visual case. You never attempted voluntary compliance in the Modern Dairy case, as I understand it.

Mr. DAY. That is right.

Mr. ANTHONY. I am trying to get at the distinction between the two cases because when I put the two cases out, taking out the names and just calling them A, B, and C, factually they look pretty close, and yet there was a vast difference in the way they were handled. I am trying to find why and how that decision was made, and what the policy is.

Mr. Kish made a recommendation that it should go from civil to criminal.

Mr. Kish, you have been working on it on a civil basis, correct?

Mr. KISH. No, sir, I was a criminal investigator.

Mr. ANTHONY. You were a criminal investigator all the way. How much criminal experience in criminal investigative experience have you had?

Mr. KISH. I have attended the white-collar criminal course in Glynco, Ga.

Mr. ANTHONY. For how long?

Mr. KISH. For a 3-week period of time; in addition, I received inhouse training.

Mr. ANTHONY. No previous experience other than that training than what you have done on the job?

Mr. KISH. I was with the Internal Revenue Service for 5 years. I worked mainly civil cases, but every once in a while I would help out on a criminal case.

Mr. ANTHONY. OK. Just very simply try to explain to me why you got involved on the criminal side, who found out what on the civil side that alerted you on the criminal side that there was more to it and at what stage in the investigation and when did you step in and start working on the criminal side.

Mr. KISH. I was assigned the criminal case in April of 1984. It was shortly after the civil case was opened. Again, there was evidence that showed up that there could be fraud, that there could be embezzlement.

Mr. ANTHONY. How many months after the civil had actually been started?

Mr. KISH. I am not sure.

Mr. ANTHONY. You are not sure.

Do you know, Mr. Day.

Mr. DAY. Sir, it was a matter of days. We opened the civil case March 21, and by the 30th we had forwarded the civil case. Mr. Kish was assigned and opened the criminal case on the 2d of April that following month.

Mr. ANTHONY. See which runs contrary to panel 1 where you had a lot of time expire before you had the cooperation between criminal and civil. Yet in your case there was cooperation within a matter of days. Yet, in one case you are acting properly, but then you take me over to another case and you don't even go civil, you don't even go criminal, you go voluntary compliance for a year and a half.

There you have laid out three different investigatory situations and you have come up with three totally different approaches. Maybe each one of them have to be that flexible, but I am trying to determine where the policy is that I could read the policy and have a better understanding of where your guidelines are and where Mr. Kish's guidelines are and where the supervisor's guidelines are in terms of when you are going to go voluntary compliance, when you are going to go civil only or when you are going to go civil and criminal simultaneously.

Can you help me understand that?

Mr. DAY. Well, these were not really simultaneous investigations. The investigation portion of the Modern Dairy's case for the civil portion had been completed. The civil investigation was then made available to Mr. Kish. He could review records and then pursue the criminal side of the case.

In that case, I think what had happened, sir, is that we saw that all of the money had been loaned from the plan, and Mr. Withers at the time had decided that he would not assign just one investigator which would naturally be assigned to an investigation, but two or three to work up a civil case. He did it as fast as he could because we were attempting to take action against a Mr. Freel as quickly as possible to get the assets back into the plan for the participants.

In this particular case, as contrasted to Visual Scene, we had badges of fraud. When I did the interview of Mr. Nash, he said Mr. Freel hid the fact from me that he was cashing out stocks and bonds.

Mr. ANTHONY. Let me stop you there. You have got the badges—is that your word, badges of fraud?

Mr. DAY. An old IRS term, sir.

Mr. ANTHONY. Badges of fraud. Weren't those badges of fraud present on the first day that the civil investigation was opened?

Mr. DAY. Yes, sir.

Mr. ANTHONY. Why, then, was a criminal investigation not started simultaneously? As I understand your testimony, you have just stated that the civil investigation was commenced and completed before the criminal investigation was initiated.

Mr. DAY. I can speculate. I wasn't the area administrator at the time, but it seems to me that we had a philosophy in PWBA throughout the years, and I have been there since 1976, that it is of utmost importance to get the benefits back for the participants rather than to put somebody in jail.

Mr. ANTHONY. I think you have just kindly broken the code of all my questions. I think that is what I have been looking for.

There is a policy and there is a philosophy that you go civil and you go civil as long as you possibly can before you go criminal, and it seems that you do that in each and every case, yet you let a lot of valuable time get away from the criminal investigators because in this particular case. If the badges of fraud were present when you finally decided to go criminal, they were present from day one, you would have thought that your civil investigator would have picked up the phone and called Mr. Kish and said, "Hey, I've got a criminal fraud case here, you ought to be involved in it."

It didn't take you long, Mr. Kish, did it, after you looked at the evidence to make a recommendation to your supervisor to go criminal?

Mr. KISH. That is correct.

Mr. ANTHONY. It didn't take long for your supervisors to agree with you to go criminal once they reviewed your report?

Mr. KISH. Yes, sir, but you must remember I was part of PWBA. I was working under Mr. Day. We were in the same office, and like you mentioned——

Mr. ANTHONY. You may be in the same office but you might as well be across town in another building, because you have got a philosophy that you are going to have a civil investigation and a criminal investigation, you all don't talk to one another from your testimony until several months have gone by before something is triggered in somebody's opinion that says that it doesn't look like we are going to get completion satisfactorily with civil, so let's now move over to criminal.

Mr. DAY. Can I comment, sir?

Mr. ANTHONY. Sure.

Mr. DAY. We are 2 weeks into the civil investigation when we open the criminal case. We knew from day one we had badges of fraud. Mr. Withers contacted the then regional administrator William Sexton and told him 2 days after I learned that there were badges of fraud, 2 days afterward, that we were going to do the civil case first. We were going to try to protect the assets of the plan, and then we were going to conduct a criminal investigation.

The criminal investigation was opened on April 2, 1984, a few days, 2 weeks after the civil investigation was opened, and 2 days after the civil case was forwarded.

Mr. POOLE. Mr. Anthony, may I address your question?

Mr. ANTHONY. Sure, Mr. Poole.

Mr. POOLE. I was the prosecutor on the case, and one factor which always presents itself when you have joint criminal and civil prosecutions going at the same time is there are legal problems with sharing information and so forth.

Once we begin a grand jury investigation on the criminal side, any information which flows back to the civil side has the potential for tainting the civil case. Rule 6(e) of the Federal Rules of Criminal Procedure prohibits us from sharing that.

Now, in a relatively small investigative agency with relatively few resources, to set up two separate investigative teams and then wall them off from each other, from a resource point of view is a difficult thing to do. It is a problem we often see.

Mr. ANTHONY. So what would be your recommendation?

Mr. POOLE. I am suggesting to you that it is often the case in a big paper case, a criminal paper case, that you start out by getting the paper, analyzing it, digesting it, tracing money, doing the sort of things that you can do without the grand jury. That also benefits the civil case. I assume that that is the work that was done on the civil side at the beginning.

When that job is done, the civil side has all the information that it can have without opening up a criminal investigation, so at that point you begin the grand jury investigation.

Mr. Anthony. Well, let's see if I can get it simpler than that. Based upon your experience as a trial attorney, handling these type cases, are you satisfied that the Government is getting its best utilization out of our resources and protecting the benefits and the principal of pension funds by using the system that we are presently operating under?

Mr. Poole. I am afraid I can't answer a question of that breadth. I just don't know. But I can tell you in this case, I think the actions taken were reasonable and there was not a harm to the criminal investigation.

Mr. Anthony. On a case-by-case basis?

Mr. Poole. In this case. I really don't have the breadth of experience to talk about other cases.

Mr. Anthony. And I guess that is the difficulty, on a case-by-case basis each one of the decisions probably do make a great deal of logic. We are challenged with the oversight responsibility to look and see if the overall policy needs to be improved.

I guess we are kind of looking at it from two different perspectives.

Mr. Poole. This case was well investigated.

Mr. Anthony. I am glad to hear you say that. The results seem to bear it out. It seems like everybody did their job. My responsibility is just to challenge the policy to see if the policy is a solid policy or whether or not the policy can be improved. My responsibility is to challenge the investigators who have been to Glynco for 3 weeks versus the IG and the prosecutor's office who have been working for 19 years.

I am just challenging everybody, including Mr. Ruud from the former panel, whether you have enough personnel, whether or not you need more training, more training money, more training programs. I guess that is what I am looking at.

I am glad to hear you say that it was a good job and you were a prosecutor and you were able to successfully take their investigation and get a good result for the public. Once that was made public, hopefully that will encourage others to cease and desist from criminal activities with pensioners' money.

Mr. Chairman, I am going to yield back my time.

Chairman Pickle. Mr. Day, in your case, one case went civil, one case went criminal. Why?

Mr. Day. In the case of Modern Dairy, sir, we had badges of fraud. We saw early on when Mr. Nash was interviewed that Mr. Freel had hidden information from him that he was cashing out the stocks and bonds, and he was loaning that money.

Mr. Nash had been hired to make a distribution of the plan assets. They were to liquidate. IRS had approved the distribution, and Mr. Nash was unaware of Mr. Freel's activities. He called us just as soon as he knew that fact, and we went on site to interview him.

We knew from day one that we had ourselves a criminal case. In the case of Visual Scene, you had two individuals who had account balances in the profit-sharing plan, and while they borrowed more than their account balance, you would call them loans, and they were loans. There was documentation of the loans. They were inadequately insured; and they weren't making the payments they were obligated to make. They seem to be genuine businessmen who had got themselves into this fix by not having enough money to pay back these loans in a timely manner.

The plan provided for loans to the trustees, and they took advantage of that. It is just that they took too much out, and they loaned the money to the corporate entity. They had a major lawsuit going against Pilkington out of England. They thought they were going to recover assets. It looked like a good case for voluntary compliance where the trustees would make restitution sometime in the near future, and they led us along, and as it turns out, they ended up losing that case, and while they were unable to make full restitution, they made enough that the nonrelated participants got their full benefit.

Chairman PICKLE. Thank you. We are going to reread the facts on these two cases and make a further analysis ourselves. It is a thin line sometimes, I guess, to determine which way you go. We are trying to get your reasoning.

Before the panel leaves, I want to ask Mr. Benages, with respect to the Massachusetts Plumbers and Steamfitters, the local case, the plan made a below-market CD deposit with the bank, between 1 and 2 percent, and then gave a low loan to a contractor, two different transactions. How much did the plan actually lose by that process?

Mr. BENAGES. The plan did not lose any money, sir.

Chairman PICKLE. Well, how much was lost?

Mr. BENAGES. The plan did not lose any money in either of the two transactions that I described. In the CD transaction, the developer paid back the bank, the CD ran its course, and the plan got its money back as well as the interest rate.

With respect to the developer, the direct loan from the plan to the developer, that loan was also paid back, with the interest that was stipulated. Our case recovered the difference between the interest that was stipulated and the going rate, the market rate. Everything was recovered, sir. There was nothing lost.

Chairman PICKLE. Well, here is a case where you took money put into your plumber pension plan and you made a CD 1 to 2 percent below the market. Why would you do that?

Mr. BENAGES. Why would the plan do that?

Chairman PICKLE. Yes. Instead of getting 9 percent, you say I will take 7 percent.

Mr. BENAGES. I believe their motivation was, sir, to make the money available to a developer through the CD purchase. You know, purchase a CD, then the bank takes that money, loans it to a developer, and the developer agrees to employ union labor in the construction project.

I believe, sir, that was the motivation.

Chairman PICKLE. So it was clear in the loan that they were to use union labor?

Mr. BENAGES. Let me say something about that, Mr. Chairman. Nowhere in that file did the trustees of that plan ever study or establish how many jobs were going to be guaranteed through this investment, sir.

Chairman PICKLE. Well, that is interesting. How many jobs were produced?

Mr. BENAGES. I don't know that, sir.

Chairman PICKLE. Well, I think I can tell you that we are advised that about 13 jobs were furnished to plumbers from the plumbers' fund. You have got several thousand dollars that has been involved otherwise, so you found 13 jobs.

Would you say, then, that the profits, the money went to contractors instead of to the plumbers in the plumbers' plan?

Mr. BENAGES. I think the profits clearly went to the contractor for the project, if that is what you are asking me, sir.

All these plumbers got were wages, OK? The plan, in terms of this investment, got the money back that was stipulated on the investment. Our case recovered the difference between the stipulated rate and the market rate.

Chairman PICKLE. Well, I think it is obvious on the surface of it that the contractors received the benefit and not the plumbers.

The gist of it was that they were just loaning money to create contracting work rather than for the plumbers.

Now, you said that no money was lost to the plan. Our files actually show from the case file that over $200,000 were lost to the plan and that only $107,000 was recovered.

Now, do you challenge that?

Mr. BENAGES. Yes, I do. Let me tell you why. I think where the $200,000 figure comes from was an estimate made by my office under my signature as to what we felt the losses were, OK?

In the course of developing the litigation in this case, we consulted with an expert. The expert told us that we were overestimating what the plan had lost. I think if you review the expert's work in this case, it would reveal that $107,000 was a lot closer figure to what was actually lost than to what we estimated, sir.

You understand we are not construction experts as such. We did a lot of work in this case, but what we did was contact local bankers, try to establish what their rates should have been, OK?

Chairman PICKLE. Who was your expert that you contacted?

Mr. BENAGES. I am sorry. I can provide you that. I can't think of it off the top of my head.

Chairman PICKLE. Will you furnish that information to our committee?

Mr. BENAGES. Yes, sir, absolutely.

Chairman PICKLE. I say, will you furnish that.

Mr. BENAGES. The information and the expert?

Chairman PICKLE. And the name of the expert who told you.

Mr. BENAGES. Yes.

Chairman PICKLE. Usually just a matter of estimate of the amount of loss. It was really $107,000 and not $200,000?

Mr. BENAGES. Yes, sir.

[The following was subsequently received:]

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210

RECEIVED
JUL 23 1990
Ways and Means
Subcommittee on Oversight

JULY 17, 1990

The Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

During the June 12, 1990 hearing of the Subcommittee on Oversight concerning the enforcement and administration of the Employee Retirement Income Security Act of 1974 (ERISA), a question was raised with respect to the Pension and Welfare Benefits Administration's (PWBA's) investigation of the Plumbers and Steamfitters Local Union 131 Pension Plan. Although your question was directed to James M. Benages, the Area Director of PWBA's Boston Area Office, I welcome the opportunity to provide the requested information and hope that our response will assist you and the Subcommittee.

As you recall, this investigation involved a Plan investment of $1.5 million in a New Hampshire Savings Bank Certificate of Deposit at 9%, with a three year term. The bank, however, was offering CDs to other depositors at higher rates of interest. PWBA's investigation disclosed that the interest rate on the CD was set at a below market rate in order to facilitate a loan to a third party for a construction project where only union labor would be used.

While questioning Mr. Benages with respect to this investigation, you asked whether the Plan suffered a loss as a result of this transaction. Mr. Benages answered that the Plan did not experience a loss through this transaction because of the consent order obtained by the PWBA's Boston Area Office which, among other things, restored $107,000.00 in lost interest to the Plan.

Based upon information obtained by the Subcommittee, you asked whether the lost interest actually totaled $200,000.00. Mr. Benages answered that the $200,000.00 figure was a preliminary estimate calculated by the Boston Area Office after consultation with local bankers. However, after consultation with an expert retained by PWBA, it appeared that the initial estimate overstated the Plan's loss. Therefore, the Plan Benefit Security Division of the Solicitor's Office, representing PWBA, entered into a series of negotiations with the Plan's attorney which eventually led to the settlement figure of $107,000.00.

During your questioning, however, Mr. Benages could not recall the name of the expert retained by PWBA. You asked that this information be submitted to the Subcommittee. The name of the expert retained to calculate the lost interest resulting from the CD investment at a below market interest rate was:

Roger F. Murray
P.O. Box 669
Wolfboro, N.H. 03894

Should you or any member of your staff have any additional questions concerning Mr. Murray's role in calculating the lost interest, please feel free to contact him. Once again, we welcome the opportunity to provide the requested information and hope that our response will assist you and the Subcommittee. If we can provide further information to you, please do not hesitate to contact my office.

Sincerely,

Alan Lebowitz
Deputy Assistant Secretary
for Program Operations

Chairman PICKLE. Let me ask Mr. McGrath if he has any questions.

Mr. McGrath.

Mr. McGRATH. Let me see if I can get my mind straight on this one. It is my belief or my understanding that this kind of arrangement exists with the pension plans of construction-type unions where they use the assets of the plans to finance construction work so that they can put their out-of-work workers to work. Is this something that goes on all the time? Am I not correct?

Mr. BENAGES. "It goes on all the time," I think, would be an overstatement. I think there is some of that that I have seen. Let me tell you how many. I think we perhaps have done five cases in the 5 years I have been in New England that were social investment issues. We close on average about 160 to 165 cases a year. So 5 of 160. You are talking 900 cases and we have seen 5 social investment cases similar to this type of case.

Mr. McGRATH. Is it not a legitimate use of their pension moneys to create work for their union members, or is the question here whether or not they get the going rate of interest on their loans?

Mr. BENAGES. I think our agency's position, sir, traditionally has been from the very beginning, that as long as the investments are not made to the detriment of the plan, the fact that they are used for social purposes doesn't concern us too much.

I think it starts to concern us when these deals are made to the detriment of the pension plan.

Mr. McGRATH. What was the return on the loan that they made to the developer?

Mr. BENAGES. Excuse me 1 second. I believe I have that down. I am sorry, sir. I thought I had it. I don't. I believe it was in the 9-percent area.

Mr. McGRATH. OK. What was the amount of interest they earned on the purchase versus what they would ordinarily get on the purchase of any other investment instrument that they may have invested their money in at that particular time? What was the differential that made you determine that they were not conducting themselves in the most fiduciary minded way?

Mr. BENAGES. OK. I think you have to compare apples with apples. I think you have to look at similar investments and the rates involved and the security for the investment and everything else and then compare the market rates with the rates that the pension fund used, and this, I think, is a valid determination.

Mr. McGRATH. Could you do that on CD's? You could do it on a bank account. You could do it on some sort of mutual fund or some stock transaction. They are going to fluctuate from time to time. Maybe you can take an average rate of, say 10 percent return a year.

If they are going to get 9, I can tell you. If they are going to get 9 for lending some money to a developer, they are going to think that for 1 percent, putting 13 people to work for a period of months or years is a very good investment for them. Those people are then paying union dues, they are not collecting unemployment, and they are doing a whole lot of things that they wouldn't ordinarily have done if they were out of work.

I may be rambling, but my experience is that I believe some of this goes on, and the extent to which it is a problem in terms of their fiduciary responsibility seems to me to be the difference in what they lent the money for and how much they could have gotten. There ought to be some way of also measuring the gain that accrued to them by putting people to work by the amount of unemployment insurance that the Government and State saved and a whole bunch of other things that ought to be taken into consideration before we go knocking down everybody's door.

Thank you, Mr. Chairman.

Chairman **Pickle**. Well, I think the question is obviously, what really is the money put into the fund for, and it is for retirement, retirement benefits. The funds were actually loaned for construction and to provide jobs for those workers in general and not for the plumbers. So you have to ask yourselves, is that a proper investment of funds. You are not supposed to do that interest free.

It looks to me like that was probably done, and I think the point we are making here is here are funds from a plumbers pension fund being loaned at below market interest rate to a developer, which is questionable, if not against the law, and at least it wouldn't be in accordance with the intent of the ERISA Act.

Would you agree with that, Mr. Benages?

Mr. **Benages**. Yes, it was against the law. That is why we brought the case.

Chairman **Pickle**. Before you leave, is the form 5500 sufficient to help you in these cases? Has it been helpful to you or not very helpful, or is information that is obtained after a year or two so old that it is really of very little help to you? What was your analysis on the 5500? Any of you want to make a comment about the 5500?

Mr. Benages.

Mr. **Benages**. I think with respect to this case, this plumbers case, I would have to say, sir, that it was not.

But let me also tell you I have a vested interest in it. I served on a committee or a work group within PWBA that has substantially amended the 5500 annual report consistent with our new data base initiative. I think for enforcement purposes, and that is my primary focus, to be frank with you, that form will be considerably more helpful than the forms and the filings that were in place when these cases were done.

In terms of retrievability, I think our data base would make this information almost instantaneously available where in the past it was not, sir. There was a 2-year delay.

Chairman **Pickle**. Mr. Day, you wanted to make a comment?

Mr. **Day**. Yes, sir.

The 5500 is the most significant enforcement tool that PWBA has, and it has provided assistance in targeting for our very limited staff in areas where we would be productive over a number of years, and we are looking forward to receiving the 5500 quicker. The additional information that is going to be included on the 5500 is going to be of great assistance to us.

Chairman **Pickle**. The panel just before you in the potash case, they couldn't get any information. They couldn't get started establishing facts whether the fund had been raided or not, and they did talk to the national union officer. They contacted the pension fund's 5500 people, and they said everything looks like it is going to be all right on the surface.

So to start with, it is difficult to know whether the form 5500 contains all the information or if anything is wrong about it. If that is so, then that means that a small union scattered across the country has a very difficult time knowing where to start.

Would you agree on that?

Mr. DAY. Sir, I think that the 5500 will present good information. I don't know why the individual couldn't obtain it or the union couldn't obtain the 5500.

Chairman PICKLE. As I understand he tried to get a 5500 and they were delayed, and finally he got a semblance of it with incomplete documentation, and here is a plan participant way out in Washington, unprotected.

How does he start? How does he or she ever establish whether the funds are being protected? That is a serious problem for us, and that is why this committee is trying to hold these hearings.

Do we have enough laws on the books now to allow movement forward in either a civil case or criminal case? Are there sufficient criminal law sanctions on our books now to take action if we will just do it, or do we need to strengthen our criminal enforcement? Anybody?

Well, we will hear testimony on that tomorrow because the question really comes down to this, if in our zeal to find and have the assets replaced, should civil suits constitute our enforcement approach. And, if anybody gets questions, or the heat moves in, they pay the fine and then we go on. Should we put more emphasis quicker on criminal activity? There is an old saying, that a good hanging is worth a dozen lawsuits.

That is what we are looking at here. The purpose of our hearing is to establish, are the plans protected and what is a better way to handle it.

I want to thank this panel for your information. We may be submitting individual questions to you because we have another panel to hear from, but I thank you very much for your testimony today.

Mr. WEILER. Mr. Chairman? I would like to make a statement.

The question about the value of the information on the 5500 form, the information is very valuable. The question is whether or not it is completed correctly and accurately and whether or not, as Mr. Ruud indicated, the form provides any concealment of information.

If that is the case, then the form has no value to the investigators or the civil people working the case.

Chairman PICKLE. Mr. Weiler, is the information that is submitted on the 5500 generally filled out completely and in proper form?

Mr. WEILER. In many cases it is not because of the complexity of the form itself and the fact that the individuals find it very difficult. If they rely on their trustees and their representatives, yes, then it is more likely to be filled out properly.

Chairman PICKLE. If I understand Mr. Benages, he said we are in better shape now than we were previously before we made some changes. There are about 10 pages of small print, and you really have to be familiar and be an expert in knowing where to look and knowing how to make evaluation of a form.

I don't know that I am recommending any changes, but it seems to me like that information isn't put down in the records, it is slow, it is not filled out properly, and the small unions suffer. I think, small plans do have difficulty in complying in good faith. So it is a serious question for us as to how to proceed.

All right, gentlemen, thank you again.

Our next panel is Paul McDonough, Michael Felsen, and Richard Coleman, and I am going to ask Earl Engelhardt, who is going to be an individual panelist, if he would come forward and just be a part of this same panel. We will get to you at the end. This way we can complete the entire proceedings.

Is Mr. Engelhardt here? I will ask you again, Mr. Engelhardt—I guess he has gone to lunch.

All right. We will start off with this panel. Paul McDonough. He is the investigator of the Boston area office of the Pension and Welfare Benefits Administration for the Department of Labor. Michael Felsen is the senior trial attorney, Office of the Solicitor of the Boston Region. And then Richard Coleman is a partner in Segal, Roitman & Coleman, attorneys in Boston.

Mr. Engelhardt is not here, but we will come back to him.

All right. Now we will hear first then from Mr. McDonough.

STATEMENT OF PAUL McDONOUGH, SENIOR INVESTIGATOR, BOSTON AREA OFFICE, PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. McDONOUGH. Good afternoon, Mr. Chairman.

Mr. Chairman and members of the committee, my name is Paul McDonough. I am a senior investigator in the Boston area office of the Pension and Welfare Benefits Administration. Accompanying me today is Mr. James Benages, the area director of the Boston area office.

I am pleased to be here today to discuss our investigation of the Massachusetts Laborers Legal Services Fund.

The investigation of the plan was opened on December 11, 1986, following a review of the plan's 5500 annual report for the year ending June 30, 1984, which revealed the payment by the plan of what appeared to be excessive operating expenses. The plan, covering approximately 9,000 participants, reported expenses of approximately $833,631.

The investigation began at the plan's office in Newton, Mass. on February 9, 1987, when I met with the plan administrator, Raymond Coia. He provided a general overview of the plan's operations and its administrative organization. I was also provided with plan documents and financial records at that time. I conducted a more extensive interview of Mr. Coia toward the completion of the investigation, after I had performed a more exhaustive review of the documents and financial records maintained by the plan.

During the course of the investigation, I conducted several interviews which focused on the plan's internal controls in providing legal services to plan participants and on the development of a cost per case figure, from which to determine the cost efficiency of the method of the delivery of legal services by the plan. I examined 650 legal case files opened by the Newton office during the 6-month period from January 1, 1986 to June 30, 1986. This examination revealed that case files were poorly organized, often incomplete, provided no indication of the time expended in addressing the participant's legal problem and glaringly highlighted the trustees' failure to develop a system of internal controls for the administration of the plan and the delivery of legal services. I reconstructed 160 case files through the extensive questioning of the plan's four in-house staff attorneys, to ascertain the type of legal service provided, the amount of time expended on the case by the staff attorney, and the matter's ultimate resolution. An approximation of each attorney's billable hours per week was also ascertained during these interviews.

From the information obtained in these interviews, I calculated the anticipated cost to the plan had the plan utilized attorneys on a contract basis rather than through in-house staff attorneys, by taking the staff attorneys' billable hours and multiplying those hours times the hourly rates which were available within the Boston area. These costs were then compared to the plan's operating costs for a 3-year period, revealing significantly higher costs for the plan under its present delivery system. I also compared a cost per case figure supplied to me by the United Auto Workers Legal Services Plan in Framingham, Mass., a prepaid legal plan providing services in the same geographic area. This comparison also revealed that the cost per case was significantly higher for the Massachusetts Laborers plan.

I also reviewed selected case files pertaining to legal matters handled by plan attorneys on a retainer basis in two satellite offices along with reports which these attorneys submitted to the administrator. This review did not disclose any major problems other than to question the administrator as to the reasons why selected cases were open so long. During the investigation I also examined expenditures, including the lease of an automobile for the plan administrator, the use of paid paralegal law students by the plan, and the establishment of what I considered a very generous noncontributing deferred compensation plan for the staff attorneys and plan administrator. Staff days expended by the Boston area office for this investigation was approximately 58 days.

At the conclusion of the investigation, I prepared a "Report of Investigation" which was referred by the Boston area office for litigation to the regional solicitor's office in Boston on August 4, 1988. Several recommendations were made including that plan fiduciaries be directed to retain an independent fiduciary to evaluate the plan's entire performance under its current organizational structure and delivery mode and to explore alternative delivery systems for the provision of the benefits. If the study concluded that alternative modes of delivery were significantly more cost effective, then the Boston area office would recommend filing suit against the fiduciaries to restore excessive costs paid by the plan. The Boston area office also recommended that the fiduciaries be directed to establish job standards for the plan administrator and to evaluate his job performance within those standards, terminate the lease agreement which provides the plan administrator with a vehicle and terminate the deferred compensation plan for the plan administrator and staff attorneys.

On August 10, 1989, the Department filed suit against eight plan trustees for violations of ERISA resulting from their failure to adequately monitor and control the quality and cost-effectiveness of service provider arrangements with the plan. In a consent order entered in Federal court on August 17, 1989, the trustees were ordered to retain a consultant to review the plan's operations. The report prepared by the consultant, based upon his review of the plan, is currently under review in the Boston area office.

Michael Felsen, a senior staff attorney in the Department's regional solicitor's office in Boston, handled the litigation for the Department and is here today to testify regarding his involvement in the case.

Thank you, Mr. Chairman. I will be happy to answer any questions you or other members of the subcommittee may have.

Chairman PICKLE. I want to thank you.

We will go next to Mr. Felsen, to whom this case was then actually referred.

Mr. Felsen, will you proceed.

STATEMENT OF MICHAEL D. FELSEN, SENIOR TRIAL ATTORNEY, OFFICE OF THE SOLICITOR, BOSTON REGIONAL OFFICE, U.S. DEPARTMENT OF LABOR

Mr. FELSEN. Yes, Mr. Chairman and members of the subcommittee. My name is Michael D. Felsen. I am a senior trial attorney in the U.S. Department of Labor's Boston regional solicitor's office where I have been employed for almost 11 years. I am pleased to appear before you today to report on my involvement with a specific case, which was selected by your committee, pertaining to the Massachusetts Laborers Legal Services Fund.

On August 9, 1988, the Boston regional solicitor's office received from the Boston area office of the Pension and Welfare Benefits Administration (PWBA) a report of investigation and accompanying exhibits regarding the Massachusetts Laborers Legal Services Fund, which will be referred to here as "the plan." Following PWBA's investigation, these files were transmitted to the Boston regional solicitor's office for legal action. In a nutshell, the PWBA investigation had revealed a failure by fiduciaries of the plan to monitor and control adequately its incurred costs, principally with respect to its main administrative staff attorney office in Newton, Massachusetts. PWBA computed losses to the plan based upon its assessment of what comparable service provider delivery systems would have cost. The investigation also revealed that relatives of various trustees were employed by the plan in capacities ranging from plan administrator to senior staff attorney to paralegal.

After the investigative file was submitted to the solicitor's office, the case was assigned to me. Upon consideration of statute of limitations issues presented in the case, I sought and obtained from the plan fiduciaries an agreement tolling the statute for a number of months to permit the parties to discuss the matter prior to the filing of adversarial litigation. Discussions between the Department and representatives of the plan trustees ensued, facts were presented, positions were debated. Upon consideration of the facts and circumstances of this case, the Department determined that, from its perspective, the case could be appropriately settled through the filing of a complaint and entry of a consent judgment in the U.S. district court. On the other hand, if it did not settle, the Department determined that the case was suitable for litigation. Further negotiations followed, with both the plan trustees' local counsel, Richard Coleman, and their special counsel, James Ray from Washington, D.C.

Those negotiations culminated in the nonadversarial resolution of this matter. The trustees agreed to a consent judgment which, among other things: One, permanently enjoins them from engaging in any action in violation of sections 404 and 406 ERISA; two, requires that, on a regular and ongoing basis, they review, monitor and evaluate the operation of the plan, including its quality and cost effectiveness in providing services for plan participants; three, requires that systems providing adequate and accurate records of utilization of plan services by participants be established and maintained by all plan service providers; four, required, within 30 days of entry of the order, that the defendants retain a consultant who shall review and evaluate the quality and cost effectiveness of the provision of legal services under the plan, including comparison with alternative available arrangements, and evaluation of overhead costs, staff compensation packages, and necessary staffing levels. The consultant, pursuant to the order, will also prepare a report including recommendations, if any, for proposed improvements; five, requires that trustees retain a consultant who shall, at least annually over a period of not less than 3 years, review and evaluate the adequacy and accuracy of legal plan service providers' records of utilization by plan participants; the consultant shall also, at least annually, submit a written report of his findings, including recommendations for improvement; and six, requires that no fiduciary defendant shall use any of his fiduciary authority to pay a fee for a service furnished by a person in whom he has an interest which may affect the exercise of his best judgment.

The consent judgment and order, signed on behalf of the Department and by each of the plan trustees defendants, was entered by U.S. District Judge John McNaught on August 17, 1989.

This concludes my prepared statement. I would be pleased to answer any questions that you or other members of the subcommittee may have.

Chairman **Pickle**. We will go now to Mr. Coleman, who is the attorney on behalf of the Massachusetts Laborers' Fund.

Mr. Coleman.

STATEMENT OF RICHARD W. COLEMAN, MASSACHUSETTS LABORERS' LEGAL SERVICES FUND, AND PARTNER, SEGAL, ROITMAN & COLEMAN, COUNSEL, BOSTON, MASS.

Mr. **Coleman**. Thank you, Mr. Chairman.

My name is Richard W. Coleman. I am a partner in the labor law firm in Boston of Segal, Roitman & Coleman. I serve as the legal counsel for the Massachusetts Laborers' Legal Services Fund.

That fund was established by collective bargaining between employers and the Massachusetts Laborers District Council in the construction industry in 1975. The bargaining parties and the original trustees decided that they wanted to establish a staff legal plan in order to provide a law office, as it were, for the laborers and their families.

The plan now covers or is available to approximately 14,000 laborers and their families in four States: Massachusetts, New Hampshire, Maine, and Vermont. Approximately 10,000 of those participants live within 50 miles of Boston.

The fund, in addition to the staff office in Newton, Massachusetts, maintains two satellite offices in the southeastern and western part of Massachusetts, and participates with cooperating attorneys in Maine, New Hampshire and Vermont to provide the legal services to the smaller number of members who are living in those three States.

The plan was established in 1975 based upon a 5-cent-per-hour contribution to the plan. When Mr. McDonough has stated that the 5500 in 1986 or 1985 indicated that there was excessive costs, I can only assume that he means that the fund was finally using up some of the reserve that it had built up. It was still funded on that 5-cent-per-hour contribution, keeping a level contribution rate for a 10-year period. The parties to the collective bargaining agreements were aware of those costs, and in 1985 had negotiated another 5-cent-per-hour contribution to make sure that there were adequate funds for the operation of the plan.

The plan provides legal services to the laborers on landlord-tenant problems, debtor-wage attachment problems, domestic relations, wills, and criminal misdemeanor cases, providing services and benefits to those members that are generally not available to working people because they are not familiar with their legal rights or the availability of legal services or cannot afford those services.

The trustees of the plan are very proud of the opportunity that they have to provide those benefits and believe that they have provided them very well over the period of years.

In January 1987, the plan was informed by the PWBA area office that there would be an audit. The trustees and the staff of the plan, including myself, cooperated fully with the examiners, or auditors, one of whom was Mr. McDonough, who I believe has an accounting background, and another auditor who had a legal background.

We provided all of the documents and all of the information requested during the audit, including, as Mr. McDonough has said, more than 650 case files of individual legal services cases that were handled by the staff attorneys.

During the course of the audit, the examiners raised some issues about record keeping, including the hourly time charge record keeping for the staff attorneys. Although the trustees did not believe that some of these records were necessary or appropriate, the trustees decided to amend their procedures and instituted more detailed time record keeping. This was based upon suggestions or questions by Mr. McDonough, and had nothing to do with the end results of the audit.

We have to remember that although the hourly record keeping is now ongoing, we do not bill anyone, so there is no purpose for billing purposes of keeping all of those time records.

The auditors were in the office for, we believe, more than 25 separate days. Some of those days both of the auditors were there together, sometimes one auditor was alone. Once the onsite audit was completed, we heard nothing from the PWBA office for 14 months other than occasionally I would see Mr. McDonough on the street and say, "How's the audit going," and he told me that he was checking with other legal funds to do some number crunching.

After the end of that 14 months, I did hear from Mr. Felsen, and he requested the trustees to sign an agreement to toll the statute of limitations for bringing a potential lawsuit so we could hopefully resolve amicably the problems that they found in the audit.

Mr. McDonough has talked about the cost per case that he computed in the audit. As I say, we never did hear from the PWBA as to what the results of the audit were. The first notice that we had that it was complete was a request to talk about resolving a court case that they were planning on filing.

After I sat down with Mr. McDonough and Mr. Felsen to discuss the issues that they wanted to raise about the audit, I went back to the fund and reviewed records myself, talked with the administrator and the accountant. I presented a detailed report to Mr. Felsen in which I pointed out my calculations of the per case cost which were considerably lower than Mr. McDonough's. I also pointed out the fact that many of the things that were raised in the conclusions by Mr. Felsen and Mr. McDonough I did not think were accurate.

For example, Mr. Felsen said if the deferred compensation plan had been originally put in and the employees had given up a raise for it, that may be OK. I pointed out that they had, in fact, given up a raise in 1987 for that deferred compensation plan.

The cost per case that Mr. McDonough had, was compared by him to the UAW plan, as he said, in Framingham, Massachusetts. I pointed out to him and included a copy of the benefit portion of the plan booklet from the UAW plan, that it is a different kind of plan than we have.

We provide full litigation costs in the areas that we cover, including domestic relations and criminal matters. The UAW plan does office work on those two areas and they then refer cases out to what they call cooperating attorneys who then charge the individual members a fee for their services, a reduced rate but nevertheless a fee. Our plan provides all of the costs of those particular cases, so it is absolutely clear and necessary that our average costs must be higher than the UAW plan.

After presenting my report to Mr. Felsen, the Department stopped talking about possible restitution from the trustees, and I have to assume that that is because in reviewing what we had said, they felt that they did not have a case to obtain restitution.

Mr. Felsen insisted, however, and said that this was his client's position, meaning the PWBA's position, that the case must be resolved by consent judgment.

The trustees were always willing to cooperate with the Department. We requested that the case be taken back from the Solicitor's office so that we could voluntarily work out an arrangement with the PWBA area office to resolve all of the issues.

We believed that we were providing good services and that we are not perfect and we are willing to improve. We want to improve. We wanted to talk about what was necessary in the Department's view to do that. We were not granted the opportunity, and they insisted on a consent judgment.

Mr. McDonough's statement seems to indicate that there was a court case filed and then we were dragged in and resolved it. In fact, the complaint, our answer in which we denied any wrongdoing and the consent judgment which had been negotiated were all entered in court at the same time.

The trustees did hire a consultant. As a matter of fact, the trustees did not wait until the consent judgment was agreed to. They hired the consultant, Gerald Mann, who runs the Municipal Legal Services plan in New York covering many thousands, over 100,000 employees and employs 137 lawyers in their staff plan.

He came in as the consultant, and he made some suggestions about legal specialization, about record keeping, some of which, although we have adopted the record keeping, it is really the bureaucratic layer of administration that really we feel is not necessary in a plan that has one attorney administrator and four staff attorneys who are supervised and overseen on a daily basis, but we went along with that.

Some of the suggestions by Mr. Mann were helpful, and the trustees were always willing to improve the plan. We did enter into the consent judgment, and we have had the full consultant's study which we have furnished Mr. Felsen at his request recently. We do have some concerns at this point about being required to retain a consultant annually for at least the next 3 years. The procedures are in place, the record keeping, detailed record keeping is in place. We went to the expense of buying a computer so that the records that we do keep can be analyzed by computer software and present reports, not necessarily because the trustees need that level of detail but frankly because if the Department of Labor is coming back to look at us, and we think they should, we know that they will be looking for them. We don't disagree with the Department of Labor's position in auditing funds. That kind of administration is necessary, and we will cooperate with them.

We do think, however, that some of the things that we got involved in are as a result of the Department insisting on consent judgments as a means of making law and establishing guidelines in lieu of publishing regulations to which plan officials can look for guidance before taking actions. This post hoc method of setting guidelines for plan operations is unfair, particularly where the Department insists on suing plan officials and issuing press releases. The ERISA policy of providing regulatory predictability and advance guidance for plan officials is defeated by this method of regulation.

Thank you, Mr. Chairman, I will be happy to answer any questions you may have.

[The prepared statement follows:]

Statement of
Richard W. Coleman, Esquire
On Behalf of the Massachusetts Laborers' Legal Services Fund

June 12, 1990

Mr. Chairman and Members of the Subcommittee:

My name is Richard W. Coleman. I am a partner in the law firm of Segal, Roitman & Coleman in Boston, Massachusetts. I serve as legal counsel to the Massachusetts Laborers Legal Services Fund.

On behalf of the Fund and its labor-management Board of Trustees, I am pleased to have this opportunity to testify before the Subcommittee on Oversight to provide the Chairman and members with some of our views concerning the administration and enforcement of the Employee Retirement Income Security Act of 1974 (ERISA).

The Legal Services Fund

The Massachusetts Laborers' Legal Services Fund was established in 1975 pursuant to collective bargaining agreements between the Massachusetts Laborers' District Council and employers of union laborers. The Fund is one of the oldest, continuously operating group legal services plans established under the Labor Management Relations (Taft-Hartley) Act. It now covers more than 14,000 laborers and their families in four states -- Massachusetts, New Hampshire, Maine and Vermont -- although about 10,000 of these participants live within 50 miles of Boston.

The Fund maintains a legal services office in the Boston suburb of Newton, Massachusetts which is staffed by full-time, salaried attorneys employed by the Fund. This reflects the original intention of the collective bargaining parties and of the labor-management Board of Trustees that the Fund should be a traditionally-modeled "staff plan" and should operate a law office exclusively for laborers and their families. To better service laborers in the southeastern and western parts of Massachusetts, the Fund established satellite offices with existing law firms in Fall River and Springfield. The much smaller number of laborers in the other covered States are serviced through a large group of cooperating attorneys in those areas. These arrangements provide a combination of a law office exclusively for laborers and their families, as well as convenient access to other attorneys. The total annual budget for the Fund is less than $1 million.

The Board of Trustees and the collective bargaining parties -- the Union and the employers of the union members -- are proud of the benefits that have been provided under the Fund for more than 15 years. Covered laborers and their families receive legal representation (and payment of litigation costs) in consumer transactions, debtor and wage attachment proceedings, domestic relations matters (for example, separation, divorce, annulment, child support, adoption), landlord-tenant problems, personal real estate transactions, bankruptcy proceedings, criminal misdemeanor cases, and preparation of wills.

These legal services impact on the everyday lives of the participants. In recent months, for example, a Fund staff attorney successfully sued a painting contractor and recovered the money paid by a participant for painting his home after the paint job failed. This case was successful, despite the fact that the state attorney general's consumer protection division had not been able to resolve the matter satisfactorily. Another participant was successful in requiring a golf driving range to erect a twenty-foot high fence to provide him with quiet enjoyment of his residence. These kinds of cases and many more are remedies of problems that are frequently unavailable to working men and women because of their limited resources and lack of familiarity with the legal process and their legal rights. The Trustees and the collective bargaining parties are pleased with their ability to provide such service to the laborers and their families.

To inform laborers and their families about the Fund's services, to promote utilization, and to provide and encourage "preventative legal care", the Fund publishes a quarterly newsletter in addition to distributing a booklet describing the Fund and its benefit programs. In addition, it conducts periodic use and satisfaction surveys among the participants.

The Fund has been enthusiastically received by the covered laborers and their families, who commence more than 2300 new matters each year. In 15 years of operation, the Fund has had only one appeal of a benefit coverage determination. Participant utilization and satisfaction with the Fund's programs has been exemplary.

This favorable description of the Fund was recently confirmed by an exhaustive evaluation of the Fund's operations by an independent, acknowledged expert in legal services plans, Gerald Mann, Esq., who serves as administrator and chief counsel of a staff prepaid legal service plan in New York covering 125,000 public employees. Mr. Mann concluded that the Fund's "beneficiaries are receiving quality legal services at a low cost."

He reached this conclusion after, among other things, conducting a comparison of the Fund with alternative available arrangements for quality and cost effectiveness. For example, he requested from a leading legal services insurer a price quotation for providing the Fund's schedule of benefits in Massachusetts. The price quotation was "almost twice the cost of providing the benefits through the present staff office model." (Emphasis added).

Mr. Mann also noted that in comparing legal services plans, one must consider which method of service delivery best serves the participants' needs and not merely relative costs. He stated that a "comparison of the cost of the various approaches to the delivery of legal services without regard to the needs of the client community and the nature of the legal services rendered is truly comparing apples with oranges." The Fund would be pleased to provide a copy of the report to the Subcommittee.

Labor Department Audit

You have asked us to briefly chronicle the ERISA audit of the Fund by the Pension and Welfare Benefits Administration (PWBA), U.S. Department of Labor.

In January 1987, the PWBA commenced a routine audit of the Fund's operations. Over the course of the following nine months, two PWBA examiners -- an accountant and an attorney -- spent more than 25 days on site at the Fund's main (Newton) office. The Fund fully cooperated with the audit and provided the examiners with access to all requested documents and files, as well as to all of the Fund's staff attorneys.

The examiners reviewed all plan documents, minutes of meetings, government filings, agreements with service providers, investment portfolios, internal and external financial statements, and work papers and invoices for co-counsel services. In addition, during the course of the audit, the examiners reviewed 600 files for individual legal service cases performed by Fund attorneys. The Fund's administrator and I, as counsel to the Fund, met with the examiners on two occasions to describe the Fund and to provide oral information that they requested. After that, the Administrator and the staff attorneys spent several hours each day during the audit with one or both examiners to review procedures, case files and time records for services performed for the participants.

In addition, many hours of staff time were consumed in providing and returning documents, files and other materials requested by the examiners. The examiners initially requested to review 200 case files. After reviewing this batch, they requested 200 more case files. And following that, an additional 200 case files were requested. After reviewing concerns about potential violations of the attorney-client privilege, the Fund gave the examiners access to all of these files so they could review the type and amount of services provided by the Fund's attorneys.

During the course of the audit, the examiners raised some issues about record-keeping, including whether the five staff attorneys should keep precise time records even though they are salaried and do not bill the participant-clients for services. The Fund's Trustees decided to accept the examiners' position on these issues and amend the Fund's procedures, even though for some of these issues there was no specific law, regulation, ruling or published guidelines requiring plans to do things in the way suggessted by the examiners. The Fund adopted a detailed attorney time-keeping system, purchased a $9,800 computer and software to implement the system, and hired a part-time employee to input attorney time entries into the system; all to satisfy the examiners' judgment that the Fund should have precise time records for the five attorneys and not rely on direct, on-site supervision.

For 14 months after the on-site phase of the audit concluded, the Fund heard nothing from the PWBA about its findings or concerns. From time to time, I would see one of the examiners on the street and inquire about the audit's status, only to be told that he was obtaining information about other legal services plans with which to compare the Fund. The Fund later learned that the PWBA had referred the Fund's case to the Regional Solicitor of Labor for enforcement litigation against the Fund and its Trustees. The Fund was given no notice or opportunity to discuss the examiners' findings or views on the Fund's operations before the matter was referred by the PWBA to the Solicitor for litigation.

The first word that the Fund received, fourteen months after the on-site audit, was a telephone call to me from an attorney in the Regional Solicitor's office requesting that the Fund's Trustees sign agreements tolling the ERISA statute of limitations for a possible lawsuit against them. The Trustees consented to the tolling agreement, and I met with the Department's attorney to discuss the Department's concerns.

After listening to the issues raised by the Department and conferring with the Trustees, I spent a considerable amount of time reviewing the records of the Fund, including the material available to and reviewed by the PWBA's examiner, I drafted a detailed response to the issues raised. In my view and in the view of the Trustees, the Department's position was inaccurate and not supported by the facts. I presented that position to the Department's attorney and suggested quite strongly that this matter was not appropriate for litigation. I also pointed out that if the PWBA had presented its examiners' views to the Fund, all matters could have been resolved appropriately and expeditiously without referral to the Solicitor's office. We requested the Department's attorney to arrange a meeting for us with the PWBA official in Washington who could authorize retrieving the case from the Solicitor's office in order to resolve the matter informally and without the attendant adverse publicity of court filings. Such adverse publicity could only have a harmful impact on the Fund, on its reputation, and on the services for its participants. Our request for a meeting with the PWBA was denied. We were placed in the position of agreeing to a consent judgment or litigating.

Initially the Department's position was that the Fund's operations were too costly compared to another type of legal services plan, and that restitution should be made to the Fund for the differential in cost. However, after considering our responses (including the fact that the Department's cost comparisons were based on comparing apples with oranges and were otherwise inaccurate), the Department, to its credit, backed off its demand for restitution. However, the Department continued to insist that the Fund revise its monitoring and record-keeping procedures, as well as hire an independent consultant, so that the Trustees would have additional information on which to determine whether the Fund's legal services could be delivered in a manner different than a staff plan at lower cost. Moreover, the Department continued to insist that the matter could not be resolved without the filing of a formal complaint in the federal district court and entry of a consent judgment.

The Trustees were willing to voluntarily agree to implement the Department's procedures, and were willing to sign a voluntary compliance agreement to this effect. I urged the Department to follow this course rather than litigate because litigation seemed such a waste of resources and inappropriately punitive in light of the Trustees' willingness to sign a voluntary compliance agreement. However, faced with continued Department insistence on a court-entered consent judgment, the Trustees agreed to this course. They saw no sense in contested litigation over actions they were always willing to take.

Over the next several months, the Fund, through its attorneys, negotiated with the Department concerning the complaint, the Fund's answer to the complaint, and the contents of the consent judgment. The consent judgment was agreed to and entered in federal court in August of 1989.

In that consent judgment, the Fund agreed to have an independent consultant who was familiar with legal services plans conduct a detailed study of the Fund, its services and expenses; in effect, this study was an additional audit of the Fund and its operations by an experienced legal services plan provider. Gerald Mann was hired to perform this required study. His findings and conclusions were discussed at the beginning of this statement. As noted above, Mr. Mann concluded that the Fund's "beneficiaries are receiving quality legal services at a low cost."

Audit Expenses of the Fund

In addition to all of the time spent by the administrator, counsel and members of the staff of the Fund during the audit, the resolution of this audit was costly to the Fund. The Fund spent over $6,600 for the consultant services in addition to more than $17,000 for representation by its attorneys. The Fund spent more than $9,800 on the purchase of a computer and software to maintain and analyze the time record-keeping system of the attorneys that was required by the Department. In addition, the Fund is required to engage a consultant annually for three years to monitor the operation, the record-keeping and the costs of the Fund, despite the favorable conclusion of the initial study by the independent consultant.

The Trustees and the collective bargaining parties continue to be extremely proud of the broad range of helpful legal services that they are able to provide for the participants and their families.

Lessons

The Trustees are aware of their obligations under ERISA and trust principles, and continue to believe that they have exercised their responsibilities in a prudent manner and in the best interests of the Fund's participants.

The Trustees also recognize the appropriate role of the Department of Labor and other agencies in monitoring and enforcing the obligations under ERISA, and will continue to cooperate with the Department as appropriate.

The Trustees believe, however, that the costs incurred by the Fund in opposing and then resolving the consent judgment and the continuing expense of employing outside consultants to review the operations, services and costs of the Fund, were and are unnecessary. This review is a function that the Trustees are able to perform and have performed (as confirmed in the first report of the independent consultant). These needless expenditures of Fund assets could be better used to provide legal services to the participants.

We also have the impression that the Department insists on consent judgments as a means of making law and establishing guidelines, in lieu of publishing regulations to which plan officials can look for guidance before taking actions. This post-hoc method of setting guidelines for plan operations is unfair, particularly where the Department insists on suing plan officials and issuing press releases. The ERISA policy of providing regulatory predictability and advance guidance for plan officials is defeated by this method of regulation.

On behalf of the Trustees of the Massachusetts Laborers' Legal Services Fund, I want to thank you for this opportunity to present our views to the Subcommittee.

Chairman Pickle. Well thank you, Mr. Coleman. This case was selected by staff for review because we found it interesting, the approach that was taken on a matter that was questionable as to its provider. It seemed obvious there were poor records kept, and there were higher costs to the legal services pension fund.

And I suppose there was a consideration given to the relationship between the plan attorneys and trustees. Did that play a factor, Mr. McDonough.

Mr. McDonough. Initially, sir, with respect to two of the trustees that were relatives.

Chairman Pickle. Two of the trustees?

Mr. McDonough. Two of the trustees. With respect to the union trustee, the plan administrator was his nephew and the senior staff attorney was the son of one of the union trustees also, sir.

Chairman Pickle. Is that illegal?

Mr. McDonough. No, sir.

Chairman Pickle. But it was a fact. Why did you compare the poor case cost of the Massachusetts Laborers Plan with the cost of, say, UAW Legal Services?

Mr. McDonough. Well, what I attempted to do was develop a true comparison between the two types of plans, and the UAW had enacted the only comparable plan in the geographic area in which the plan is located, sir.

Chairman Pickle. Well, did you consider at the very beginning seeking voluntary compliance in this case?

Mr. McDonough. The decision to seek voluntary compliance would not be made by myself, sir, but would be made by the area director, James Benages?

Chairman Pickle. Well, you did not recommend voluntary compliance approach, then?

Mr. McDonough. No, I don't make that decision, sir.

Chairman Pickle. But you make a recommendation to who, Mr. Felsen?

Mr. McDonough. I had discussions with the area director and the ultimate decision was made by him.

Chairman Pickle. Then you made no recommendation to him?

Mr. McDonough. I had discussions with Mr. Benages, yes, sir.

Chairman Pickle. Mr. Felsen, since he points to you, did you make any recommendation for voluntary compliance at this point?

Mr. Felsen. Mr. Chairman, I believe what Mr. McDonough was saying is that he had discussions with his area director in the Pension and Welfare Benefits Administration. I am with the solicitor's office of the Department of Labor. We receive cases after they they have concluded their discussion, and the area director has made a determination that the case is appropriate for litigation.

So I was not involved in those earlier discussions by the administrative agency.

Chairman Pickle. Well, I am sure then that you did not recommend to PWBA that they would request voluntary compliance before filing a lawsuit; is that correct?

Mr. Felsen. No. Again, that is not my role. I am not involved in the process at that point. I receive a case once the determination has already been made that the case is suitable for litigation.

At that point I have to make a determination within the regional solicitor's office as to whether, in fact, it is suitable for litigation.

Chairman **Pickle**. Well, did you file a lawsuit at that point?

Mr. **Felsen**. No, we did not file a lawsuit when we received the file. We received the file, we analyzed the file, and then we had discussions, I had discussions both with Mr. Benages and Mr. McDonough and Mr. McDonough and with Mr. Coleman, and also with Mr. Ray, and ultimately, we reached the conclusion that a consent judgment was an appropriate disposition.

Chairman **Pickle**. Here is a survey, a study and an investigation made about these high costs, and the quality of the work, and the possible relationship between trustees and the parties involved, and it is a question of the efficiency and accuracy of the plan.

Did any of you at the beginning think that there was any illegal or criminal action, they were making loans or giving grants or in any way passing along money to someone else illegally?

Was there any criminal—suspicion of involved?

Mr. **McDonough**. There were no indication of that with respect to the fund, sir.

Chairman **Pickle**. No indication, all right. So it was a matter of saying to them, our study shows that you have higher costs, and are not doing quality work, and you have got to improve the quality of your performance. Now, you made the report to Mr. Felsen, and you talked to him, but you didn't make any recommendation. Now, Mr. Felsen didn't ask anybody, you didn't ask anybody for voluntary compliance, did you?

At this point then was the case just turned over to Mr. Coleman?

Mr. **Felsen**. Mr. Pickle, my role in the solicitor's office is to receive a file from the Pension and Welfare Benefits Administration.

Chairman **Pickle**. All right.

Mr. **Felsen**. And once we receive it, we make an evaluation of the case to determine whether in our legal opinion it is suitable for litigation. We made the determination that it was indeed suitable for litigation. I also engaged in discussions with Mr. Coleman who represents the fund regarding the kinds of issues we saw presented by this case.

Ultimately, we determined that appropriate dispositions of the case would be to not seek monetary damages, but to ensure that for the future, the plan was operated appropriately and effectively, and that an independent eye was brought in to take a look at the entire operation, and with respect to specific aspects of the operation.

Chairman **Pickle**. Well, Mr. Felsen, do I misunderstand you or do I understand you that when you receive the data from Mr. McDonough, you make a determination that this case was suitable for litigation?

Mr. **Felsen**. Yes.

Chairman **Pickle**. And that you then turned it over to Mr. Coleman?

Mr. **Felsen**. I represent the plaintiff, and Mr. Coleman represents the defendant.

Chairman **Pickle**. Now, at that point when you recommend to turn it over for litigation, why did you not ask the plan to ask for voluntary compliance? Is that within your realm of jurisdiction?

Mr. **Felsen**. Again, once a case comes to my office, we make a determination whether or not it is suitable for litigation. In view of the Department, this case was suitable for litigation, and it was an appropriate candidate for a consent judgment which would be an enforceable order. As far as whether there was a determination as to whether voluntary compliance was an option, basically——

Chairman **Pickle**. Well, you don't have anything to do with whether they should seek voluntary compliance or not. Your jurisdiction is is it suitable for litigation or not?

Mr. **Felsen**. That is correct.

Chairman **Pickle**. And at no point did either of you just say to the plan we have got to have voluntary compliance, let's cut this out, that wasn't done?

Mr. **Felsen**. Again, Chairman Pickle, that ordinarily would occur at the earlier stage before my office received it.

Chairman **Pickle**. All right. Now, Mr. Coleman, you got the case, and you went through a long discussion of all the things you did. What did your services cost the plan.

Mr. **Coleman**. Between myself and Mr. Ray, who we hired as outside counsel and who is very familiar with ERISA and the Department of Labor Administration, it cost I believe it was $17,000.

Chairman **Pickle**. Well, I understood from your testimony that you represent the plan. Now, I understood from your testimony that it cost, I don't have it in front of me, but I thought it ran $25,000 or $30,000; $6,600 for the consultant fee, $17,000 for the representation by the attorneys, and you spent more than $9,880 for the purchase of computer and software to maintain and analyze the recordkeeping.

Mr. **Coleman**. Right, Mr. Chairman.

Chairman **Pickle**. If all those would be totaled, that would be somewhere in the neighborhood of some $30,000; is that correct?

Mr. **Coleman**. That is correct.

Chairman **Pickle**. Now, I am just asking myself, you go from one, two, three steps and nobody has asked the plan why you are not doing good, quality work, and why is it at such a high cost? No one told the plan to change. Instead, you went through the paces, and I am just wondering why we have taken this approach rather than just simply asking for voluntary compliance to begin with?

Mr. **Coleman**. That is the exact question I asked in December of 1988, Mr. Chairman.

Chairman **Pickle**. Why did you not handle that at the beginning.

Mr. **Coleman**. As I understand it, if I could clarify, Mr. Chairman, Mr. McDonough works for the area office of the PWBA. The gentleman to his left, Mr. Benages is the area director. It is his responsibility to make that decision. He apparently made that decision and turned the case over to Mr. Felsen in the solicitor's office. We said please, give it back to Mr. Benages and Mr. McDonough, let us talk, let us have some voluntary compliance.

We have no problem in changing things and improving. We want to improve it. They wouldn't let us do it?

Chairman **Pickle**. Mr. Coleman, I asked, and then Mr. McDonough, or Mr. Benages, why didn't you do that? To me it would seem to be the simple, logical, efficient, quick way to do it. Why didn't you?

Mr. **Benges**. I will tell you, sir. Back in 1979, there was a case done by the Boston office, the guy that signed the voluntary compliance letter that was issued at that time, my predecessor, the issues on that case were relatively minor administrative expansion issues, the issues that were covered by the voluntary compliance issued by the Boston area office in 1979. That letter, sir, was ignored. That letter, and the issues that were raised were never addressed, OK?

What we were addressing here I thought were considerably more difficult issues, and looking at the history of our relationship with this fund in terms of oversight responsibility, I didn't feel that we were going to get anywhere with a voluntary compliance letter. Looking at it historically, since the issues were considerably more difficult issues than the issues that were addressed in the 1979 letter.

Mr. **Coleman**. Mr. Chairman, could I respond to that?

Chairman **Pickle**. Who is speaking?

All right, Mr. Coleman.

Mr. **Coleman**. Mr. Benages says that the 1979 voluntary compliance letter was ignored. I think that is patently false, not deliberately false, but false. The trustees and the attorney for the trustees at that time and the administrator submitted letters to the area administrator to define the exact steps that they had agreed to take and, in fact, did take and invited the Department of Labor to come back at any time after those steps were completed to verify as to whether or not they were done. Those steps were, in fact, done; the Department did not come back until 1987. The things that were raised in the audit in 1987 were not repetitions of what was identified in 1979. The relatives issues was a question in 1979; it was resolved. There still was no problem with relatives, there was no allegation in 1987, that there was any moneys missing, that there was anything done inappropriately having to do with relatives.

The issue about recordkeeping was not raised in 1979; it was raised in 1987, and voluntarily resolved during the audit.

Mr. Felsen talked about the independent eye, the consultant that they insisted that we hire. We did hire that consultant. That consultant conducted an exhaustive study of the plan, and he concluded that sure, maybe they could keep better time records, but he concluded that the plan participants were receiving probably better quality legal services from our staff plan in Newton, Mass. than they would have had they gone to private attorneys and they were receiving that at lower costs.

The whole idea of the trustees spending too much money to provide the services was a conclusion that was made during the audit. We think it was an incorrect conclusion, and the consultant that the Department wanted us to hire agreed with us, that the costs, in fact, were low; the quality of service was high.

Chairman **Pickle**. Why do you think the party just preceding you, Mr. McDonough and Mr. Felsen did not receive voluntary compliance?

Mr. **Coleman**. I have been asking myself that question for about a year and a half, Mr. Chairman, and I have not come up with any good answer. I have had no conversations with the PWEA about it other than in the one meeting that we had with Mr. McDonough and Mr. Felsen. I don't know.

Mr. **Felsen**. Mr. Chairman, if I may just say?

Chairman **Pickle**. All right, Mr. Felsen.

Mr. **Felsen**. With respect to the question of the cost of this plan, in my opinion, a very indepth investigation was conducted by PWBA. The difficulty in the prepaid legal services field is that the comparables are inexact. It is difficult to come up with precise comparables. The fact is Mr. McDonough did the best that he could in terms of comparables. He did an exhaustive search for comparables, and the only ones that he could find indicated that the plan was spending a lot of money, and I thought that we would maintain that was the case, and that presumably still is the case.

That is the reason that we insisted that there be a further study of this question by an independent consultant.

Frankly, we received the consultant's report, we are reviewing it, and we believe, in fact, it has some deficiencies in it. We intend to check into those with the consultant. But in defense of the forwarding of this file to my office for litigation, in the area offices review, there were serious expenditures that were incurred which in their view were not necessary. From a litigation standpoint, the solicitor's office determined that there were problems of proof in terms of really being able to convince a judge of this, because the comparables are inexact, and it is difficult to come up with them.

But in defense of the investigation, it was a good investigation, it was a good faith investigation, and the investigation in good faith found over expenditures. Through negotiations, all parties agreed to a consent judgment, which in my view, adequately addressed the issues that were presented And hopefully, the defendants felt the same way, too, because they signed the consent judgment.

Chairman **Pickle**. Mr. Coleman, do you have any response to that?

Mr. **Coleman**. Yes, Mr. Chairman.

The plan did sign the consent judgment because the plan was placed in the position of either sign a consent judgment and do things that it was willing to do through voluntary compliance or litigate and expend an awful lot of money to litigate a case.

And even if the plan won, it would have been doing the same things at the plan; that is, improve the recordkeeping which they did after Mr. McDonough raised some issues and hire a consultant which they had done at the suggestion of Mr. Felsen months before we actually reached consent judgment.

So that is why they entered into the consent judgment. It did not make sense to litigate and spend a lot of money, and that is why we had requested the solicitor's office to send the case back to the PWBA and engage in voluntary compliance.

And when we are talking about high costs, we ought to put that in perspective, as well. We are talking about a small plan, which spends less than $1 million a year for 14,000 people. We are talking about originally a 5-cent per hour contribution, not an awful lot of money today, and now a 10-cent per hour contribution. The high cost that they are complaining about is somewhere over $500 per case.

Our calculations is a per case cost in the high three hundreds, or somewhere in the four hundreds, depending on how you calculate it.

The UAW plan is talking bout $230 per case. If anyone in this room has gone to a lawyer, including myself, lately, you don't get much for $200 or $400 or $500. That is the level of excessive costs that we are talking about, Mr. Chairman.

Chairman **Pickle**. Well, I find this procedure and the difference of opinion rather important. I think the staff and our solicitor general may want to look into this further.

It's not my contention something wrong was done. It just seems to me like we have made a mountain out of a molehill, or at least we took a course that wasn't necessary, could have been handled easier, and we wanted to understand why.

And obviously, there is no agreement here, but we are going to make further inquiry about this whole procedure.

I guess that is about the sum of this particular case. I don't have any other questions of you, but we are going to look into this further.

So, I thank you.

Now, you gentlemen can stay at that table and we will hear Mr. Engelhardt. You have just arrived.

I don't have any further questions of you gentlemen, so if you want to leave or you can stay there, but I will hear Mr. Engelhardt now.

Mr. Engelhardt is a participate in the United Technologies Corp., Carrier Employees savings plan, and we will now hear from you, Mr. Engelhardt. We called your name earlier, and you were not in.

Will you proceed now?

STATEMENT OF EARL C. ENGELHARDT, COVINA, CALIF., PARTICIPANT, UNITED TECHNOLOGIES CORP., CARRIER EMPLOYEES SAVINGS AND INVESTMENT PLAN, ACCOMPANIED BY ROGER J. THOMAS, PARTNER, BELL, BOYD & LLOYD, WASHINGTON, D.C.

Mr. **Engelhardt**. Certainly.

Chairman Pickle, members of the subcommittee, I wish to thank you for this opportunity to testify before your committee concerning what I believe to be a need to improve and enhance and enforce our Nation's pension welfare and benefit laws on behalf of its citizens.

I wish to relate my experiences, which I have come to believe is all too unfortunately representative of a number of workers and retirees who are faced with similar problems concerning their entitlement to pensions and health benefits from their employers.

I had nearly 30 years of service with Spectrol Electronics, a subsidiary of Carrier Corp., at the time of the United Technologies Corp. takeover. I had been told by various executive members of management that my earned benefits were protected by Federal law, ERISA.

I also had been receiving regular statements given to me by Carrier Corp., and then United Technologies, as to the status of my total retirement package in a summary booklet form. I had the belief that nothing could affect my personal retirement benefits that I had earned.

I also had formal copies of the Carrier Employees Securities and Retirement Plans in my possession and an understanding of the law that states that the retroactive reduction of benefits is not permissible. So, believing that I had earned these benefits, I planned my personal financial future accordingly.

Then, in a takeover, United Technologies acquired Carrier Corp. During the reorganization by United Technologies, the Carrier pension committee in Syracuse, N.Y. was dissolved. The United Technologies pension committee in Hartford, Conn. immediately changed the service measurement because it was not the same way the United Technologies' plans were administered.

About that same time, by plan amendment, United Technologies ended a provision in the Carrier plan allowing a single lump sum distribution at time of retirement. Both of these changes were important to my future financial security.

I immediately went to the Spectrol executive management about the changes, and then to the United Technologies executive management in an attempt to correct his injustice.

United Technologies was arrogant and indifferent and lacked any interest. They furthermore published information which I believe erroneously conveyed the status of the pension and welfare benefits programs to the Carrier plan participants. Essentially I was told, "That's tough, but that's the way it is."

I then went to the Department of Labor in both Los Angeles and Washington. Because of a pension booklet I had received, I believe that the Department of Labor was responsible for assuring the legality of Spectrol's plans.

After completing many Department of Labor forms, supplying great detail as to the many changes that United Technologies was making to the Carrier plans, I forwarded them to the Department of Labor with a letter to the then Assistant Secretary David Walker stating my feelings.

I received a letter back from the Department of Labor basically stating that it's not their problem. The Department of Labor only monitors the plans; the IRS is the enforcement body. It was the IRS that was supposed to protect my rights.

I then went to the IRS, first in Los Angeles, then in Washington. I was told by the IRS that they did not have the time or staff to investigate my claims. They were simply too busy and understaffed. I explained that I believed hundreds of millions of pension and welfare benefit dollars were at stake. They had no interest.

I then started calling randomly to IRS and other governmental offices in Los Angeles and Washington, always asking for help or the name of someone who might be able to help me. Then I reached a person in the IRS who told me that I would never be able to do anything by myself. He said, go to your Congressman, have him prepare a letter to the IRS to investigate my claims.

I went to my Congressman, David Dreier. I never saw him, but his staff prepared a letter to the IRS based on information obtained from me and the Department of Labor forms and letter. I received a letter from the IRS indicating that I should furnish additional information and they would inquire further.

I furnished the information but received no further response from the IRS. Copies of the correspondence are attached for your review.

Understand, through all of this, I had never been told that I was wrong or incorrect about my assumptions and my understanding of the law from anyone.

I now became more and more convinced that no governmental agency or their staff would help me, so I began an attempt to find an attorney and to organize a class action suit against United Technologies. I found no attorney that would even talk with me about the issues.

I was surprised to learn that I could not seek damages, therefore the legal community had no interest. I went to the Los Angeles Bar Association, the Orange County Bar Association, the San Bernardino and San Diego Bar Associations, with no help.

I called lawyers randomly from the phone book. No help. I went to the AARP—of which I am a member—and the ACLU. Both told me to obtain legal counsel, but not theirs. The AARP said they would publish an article about my situation in hopes that I could reach the many Carrier employees affected by these changes. I got lots of talk, but no article.

Subsequently, I phoned the AARP and got the number of Bell, Boyd & Lloyd here in Washington. I called and subsequently spoke with Roger Thomas who has greatly helped me. I have also spoken with Karen Ferguson of the Pension Rights Center in Washington who has also been very helpful.

Mr. Thomas assisted me and prepared an extensive letter describing the potential violations under ERISA and the Tax Code to Vincent J. Rotolo of the IRS in New York. A copy of the letter is attached to my testimony. To this date, we have received no acknowledgment or response to this letter.

I am still trying to organize a class action suit against United Technologies. I have personally committed hundreds of hours of time and effort to organize this class action and have received funds from a number of employees, but not yet sufficient funds to meet the cost of litigation.

I still find it hard to believe that I am unable to get any help from Congress, the Department of Labor or Internal Revenue Service to get what I believe are straightforward answers to very simple, basic questions.

That's why I'm here. I need help to get the IRS, or someone in Government, to do something. United Technologies does not appear to be concerned with anyone in Government, although I am not sure why they should. There is no penalty for what they have done. As there are likely many millions of people in similar situations, I ask that you help me to get the IRS to act.

I encourage this committee to consider demanding that the Federal agencies provide more support and assistance for people like me and to provide appropriate incentives for private attorneys to bring civil actions to protect my and the benefits of others in pension and welfare plans which may have committed violations of the law.

Mr. Thomas, who has assisted me in my efforts, is here to respond to any specific questions which you may have regarding our efforts.

Thank you for this opportunity to testify, and I look forward to any questions you may have.

[Attachments to Mr. Engelhardt's statement follow:]

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ENERGY AND AGRICULTURE

TASK FORCE ON EDUCATION
U S MEXICO INTERPARLIAMENTARY
CAUCUS
TASK FORCE ON POW MIAS
JOINT TASK FORCE ON AFGHANISTAN

August 19, 1988

Mr. Earl C. Engelhardt
4402 Heathdale Street
Covina, California 91722

Dear Mr. Engelhardt:

This is in response to your request for assistance with your problem concerning the Internal Revenue Service (IRS).

In response to my inquiry on your behalf, Eugene D. Alexander, District Director, has provided me with the information contained in the enclosed letter.

I will be in contact with you as soon as further information becomes available. In the meantime, please advise me of any new information you may receive.

Sincerely,

David

David Dreier
Member of Congress

DD:jc
Enclosures

Internal Revenue Servi.

District
Director

Department of t. Treasury

35 Tillary St., Brooklyn, N.Y. 11201

Date: JUL 2 6 1988

The Honorable David Dreier
Member of Congress
112 North Second Avenue
Covina, California 91723

Dear Mr. Dreier:

We are in receipt of your letter dated June 3, 1988, in which your constituent, Mr. Earl C. Engelhardt, has requested your assistance is securing an investigation of the changes made by United Technologies Corporation of Hartford, CT., in the Carrier Corporation Plans, in which he is a participant.

Mr. Engelhardt alleges the following changes were made to the Carrier Employee Savings and Investment Plan, and the Carrier Retirement Plan A:

1. Investment options and how plan participants could redirect their investments were eliminated or altered.

2. Lump sum distributions were eliminated.

3. Benefit structure and formula were redefined to measure salary time in the salary plan and hourly time in the hourly plan.

Further, Mr. Engelhardt alleges the above changes were made retroactively and without proper notification given to plan participants. He believes retroactive changes are illegal under the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC).

Plan sponsors may make retroactive amendments to their plans as long as they comply with the applicable provisions of ERISA and the IRC. However, the information supplied by Mr. Engelhardt is insufficient to make a determination of whether or not the above changes were properly made.

Please be assured that the Internal Revenue Service maintains an examination program to review the operation of Pension and Profit Sharing Plans. The purpose of the program is to ensure compliance with the provisions of the plan and the applicable tax laws. We will give the information careful consideration. In order for us to review your constituent's allegations, we need additional information, including the name of the plans involved and the employer identification numbers of these plans.

Please ask your constituent to mail this information to the following address:

Internal Revenue Service
GPO C-9075
Brooklyn, New York 11202
EP/EO:RPM

When we receive this information, we can then evaluate your constituent's allegations under the examination program. Pursuant to Internal Revenue Code Section 6103, we are barred from providing any information as to the disposition of this matter.

If you require further information, please contact Vincent J. Rotolo, Returns Program Manager, at (718) 780-6134.

Sincerely yours,

Eugene D. Alexander
District Director

BELL, BOYD & LLOYD
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

1615 L STREET, N.W., SUITE 1200
WASHINGTON, D.C. 20036
TELEPHONE (202) 466-6300

TELECOPIER (202) 463-0678
TELEX 989966 (BBL WSH UD)

CHICAGO OFFICE
THREE FIRST NATIONAL PLAZA
70 WEST MADISON STREET
CHICAGO, ILLINOIS 60602
TELEPHONE (312) 372-1121

OAK BROOK OFFICE
2001 SPRING ROAD
OAK BROOK, ILLINOIS 6052
TELEPHONE (312) 573-1999

September 20, 1988

Mr. Vincent J. Rotolo
Returns Program Manager
Internal Revenue Service
GPO C-9075
Brooklyn, New York 11202
EP/EO:RPM

Dear Mr. Rotolo:

This is in regard to a July 26, 1988 letter from Mr. Eugene Alexander, District Director, Internal Revenue Service, Brooklyn Office to the Honorable David Drier concerning his constituent and my client, Mr. Earl C. Engelhardt. Mr. Engelhardt is an employee of Spectrol Corporation, a subsidiary of United Technologies, and a plan participant of the Carrier Retirement Plan A and the Carrier Employee Savings and Investment Plan (the Plan). The July 26, 1988 letter refers to three specific allegations by Mr. Engelhardt with respect to these plans. These allegations are that:

(1) Investment options and how plan participants could redirect their investments were eliminated or altered.

(2) Lump sum distributions were eliminated.

(3) Benefit structure and formula were redefined to measure salary time in the salary plan and hourly time in the hourly plan.

As noted in the letter, Mr. Engelhardt alleges that these changes were made retroactively and without proper notification given to plan participants. The letter from Mr. Alexander goes on to indicate that plan sponsors may make certain retroactive amendments to their plan as long as they comply with the applicable provisions of ERISA and the Code. The letter further indicates that the information supplied by Mr. Engelhardt is insufficient to make a determination of whether or not the changes alleged were properly made and indicates additional information concerning these plans, including the name of the plans involved and the employer identification numbers of these plans, should be furnished.

In response to the July 26, 1988 letter from Mr. Alexander, I would like to furnish, on behalf of my client, the following information pertaining to these allegations. However, the information which I am furnishing relates only to the Carrier Employees Security Plan, Plan A (the Plan) (EIN 06-0991716)(PN-001), and not to the Carrier Employees Savings and Investment Plan (EIN 06-0991716)(PN-002).

Mr. Engelhardt has alleged that the Plan has been amended to eliminate an optional form of benefit in violation of 29 U.S.C. § 1054(g) of Title I of ERISA and § 411(d)(6) of the Internal Revenue Code of 1986 (the Code). Specifically, § 411(d)(6) of the Code provides that:

> (6) Accrued benefit not to be decreased by amendment.--
>
> (A) In general. - A plan shall be treated as not satisfying the requirements of this section if the accrued benefit of a participant is decreased by an amendment of the plan, other than an amendment described in section 412(c)(8), or section 4281 of the Employee Retirement Income Security Act of 1974.
>
> (B) Treatment of certain plan amendments. - For purposes of subparagraph (A), a plan amendment which has the effect of--
>
> (i) eliminating or reducing an early retirement benefit or a retirement-type subsidy (as defined in regulations), or
>
> (ii) eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment shall be treated as reducing accrued

> benefits. In the case of a retirement-type subsidy, the preceding sentence shall apply only with respect to a participant who satisfies (either before or after the amendment) the pre-amendment conditions for the subsidy. The Secretary may by regulations provide that this subparagraph shall not apply to a plan amendment described in clause (ii) (other than a plan amendment having an effect described in clause (i)).

The Conference Report to the Retirement Equity Act (REA) (Senate Report No. 98-575 of August 6, 1984) which amended ERISA to prohibit the elimination of the lump sum option, provides on page 30 of that report that "the committee expects that regulations will not permit the elimination of a lump sum distribution option because, for a participant or beneficiary with substandard mortality, the elimination of that option could eliminate a valuable right even if a benefit of equal actuarial value (based on standard mortality) is available under the plan."

With respect to the elimination of the lump sum option under the Plan, section 6.7 of the Plan, captioned "Optional Forms of Payment", formerly stated that:

> In lieu of the standard form of payment to which he might otherwise be entitled, a Participant may elect to receive his Retirement Annuity under any one of the following forms of payment which are the Actuarial Equivalents of the standard forms of payment prescribed by Section 6.6 provided that the requirements of section 6.11 are met:
>
> (c) . . . If the optional form of payment pursuant to this subsection (c) is to be in the form of a single sum to the Participant the amount of such payment shall be determined on the basis of the mortality rates used in the 1971 Group Annuity Table.

Correspondence and other communications from the parent company, United Technologies Corporation, have indicated that the lump sum option has been eliminated from the Plan. Specifically, an attachment to the Plan document entitled "Amendment to the Carrier Employees Security Plan, Plan A," states that:

> The Carrier Employees Security Plan, Plan A is amended as follows:
>
> 1. Effective January 1, 1988, Section 6.7(c) is deleted from the plan. On and after January 1, 1988 the distribution of benefits from the Plan shall be in accordance with the forms of annuities specified in Article 6. The Committee shall no longer have discretionary authority to effect other forms of distribution.
>
> 2. No distributions shall be made after December 31, 1987 that require the approval of the Committee except that employees of the Controls Division at the Spectrol and New Lexington facilities who, on or before December 31, 1987, elect to retire and receive a single lump sum distribution of their retirement benefit and such election is received in the Plan Administrator's office on or before December 31, 1987 shall be entitled to receive their benefit in the form of a single lump sum distribution provided that such participants actually retire no later than May 1, 1988.
>
> 3. Appendices H and I, attached hereto, are hereby incorporated into the Plan.
>
> The Plan amendment dated December 24, 1987 is signed by J. Thomas Bouchard, Senior Vice President, Human Resources and Organization, United Technologies Corporation.

Please note that with respect to the allegation that the Plan amendment which removed Mr. Engelhardt's right to obtain a lump sum distribution represents an impermissible reduction in his accrued pension benefit in violation of 29 U.S.C. § 1054(g) of Title I of ERISA that, a letter requesting confirmation of his right to obtain a lump sum distribution under the Plan was sent to Spectrol and United Technologies.[1]

United Technologies, in a letter of August 31, 1988 in response to our letter, has indicated that in their view, since Mr. Engelhardt had not reached age 55 by December 31, 1987, the date upon which the amendment to eliminate the discretionary lump sum provision from the plan was effective, Mr. Engelhardt would not be eligible to receive a lump sum since at that point, he would not be eligible to retire under the terms of the Plan. United Technologies further indicates in its response that the provision eliminating the lump sum option was in accordance with, "recent IRS regulations prohibiting such discretionary payment provisions".[2]

I believe that the position that has been taken by United Technologies with respect to Mr. Engelhardt's entitlement to a lump sum distribution of his benefit is in error with respect to the requirements of section 204(g) of Title I of ERISA and section 411(d)(6) of the Code. Specifically, section 301 of Title III of the Retirement Equity Act of 1984 amends section 411(d)(6) of the Code to provide that an accrued benefit may not be decreased by an amendment of the Plan which has the effect of:

> (i) eliminating or reducing an early retirement benefit or a retirement-type subsidy (as defined in regulations), or
>
> (ii) eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment shall be treated as reducing accrued benefits. In the case of a retirement-type

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[1] See Attachment I, copy of August 11, 1988 letter to United Technologies regarding optional lump sum benefit.

[2] See Attachment II, copy of August 31, 1988 letter from United Technologies regarding optional lump sum benefit.

> subsidy, the preceding sentence shall apply only with respect to a participant who satisfies (either before or after the amendment) the pre-amendment conditions for the subsidy. The Secretary may by regulations provide that this subparagraph shall not apply to a plan amendment described in clause (ii) (other than a plan amendment having an effect described in clause (i)). (emphasis added)

An examination of the recent final regulations concerning section 411(d)(6) of the Code issued by the Internal Revenue Service on July 11, 1988, 53 F.R. 26050, indicate that under § 1.411(d)(4) "Section 411(d)(6) protected benefit" that a single or lump sum distribution is an optional form of benefit that is protected under 411(d)(6) of the Code and the final regulations. However, the final regulations do not clarify the application of section 411(d)(6)(B)(ii) with respect to whether or not a plan amendment described under clause (ii) would have the same effect as an amendment under clause (i). Specifically, 411(d)(6)(B) provides that "in the case of a retirement-type subsidy, the preceding sentence shall apply only with respect to a participant who satisfies (either before or after the amendment) the preamendment conditions for the subsidy. The Secretary may by regulations provide that this subparagraph shall not apply to a plan amendment described in clause (ii) (other than a plan amendment having an effect described in clause (i))." (emphasis added).

It is clear that a lump or single sum distribution has the effect of a benefit described in clause (i) and, for this reason, an individual who subsequently meets the eligibility requirements for a lump sum benefit, after a plan amendment has eliminated that lump sum benefit, is nonetheless entitled to that benefit when the preamendment eligibility requirements are met. The importance of a lump sum benefit and its inclusion as a protected benefit under clause (i) is demonstrated by a statement in the Conference Report to REA[3] that, "the regulations also could permit the elimination of an option if (1) the elimination of the option does not eliminate a valuable right of a participant or beneficiary, and (2) the option is not subsidized or a similar benefit with a comparable subsidy is provided". (emphasis added The Conference Report goes on to state that "the committee expects that the regulations will not permit the elimination of a 'lump sum distribution' option because, for a participant or beneficiary with substandard mortality, the elimination of that option could eliminate a valuable right even if a benefit or equal actuarial value (based on standard mortality) is available under the plan." (emphasis added)

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[3] Retirement Equity Act of 1984, P.L. 98-397, Senate Report No. 98-575 at page 30 of the Conference Report.

It is therefore clear that the regulations of the Secretary, based on the Conference Report and an explicit reading of 411(d)(6), must protect the accrual of benefits with respect to a participant, and in this case, entitlement to a lump sum distribution option, for a plan participant who subsequently meets the preamendment requirements for distribution of the lump sum option under the plan.

Therefore, Mr. Engelhardt, upon meeting the relevant age and service requirements for benefits under the Plan will, upon meeting such preamendment eligibility requirements, will be entitled to receive his accrued benefit in the form of a lump sum as previously provided under 6.7 of the Plan.

The second allegation of Mr. Engelhardt is that calculation of hourly and salaried credit under the Plan has been changed in a manner to reduce the accrued benefit of a worker who has both hourly and salaried accrual credit under the Plan. Specifically, after United Technologies acquired Carrier Corporation and Spectrol, calculations regarding individuals with both hourly and salaried service was changed. Under the previous policy enunciated in 1970 by the Pension and Benefit Committee, crediting for retirement benefits for a person with both hourly and salaried service, who subsequently retired as a salaried employee, provided that an individual with hourly service receive full credit for all service as a salaried service. After the acquisition of Carrier and Spectrol, crediting of combined hourly and salaried service was changed to provide that hourly and salaried service be calculated separately and that a separate calculation is being performed for all Plan service.[4]

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[4] See Attachment III, copy of memorandum to Robert C. Christensen concerning "Benefit Calculation for Split Service

(footnote continued)

The above change was not accomplished through any substantive amendment of the Plan but, rather appears to represent an administrative reinterpretation of how benefits are to be calculated, with combined hourly and salaried service under the Plan.[5] We are aware that a decision to credit hourly service as salaried service was made by the Pension and Benefit Committee of the Carrier Plan in 1970 and, presumably there is a memorandum which details the specifics of this interpretation of service crediting under the Plan.

Article Three of the Plan document, which relates to crediting of service, provides under section 3.6, "Transfers" states that:

> If, as a result of a direct transfer, either from within the Employer or from an Affiliate, an employee of an Employer thereby becomes an Employee, the Employee's service for the purpose of determining eligibility for benefits under the Plan (including the determination of his right to participate in the Plan and his right to a nonforfeitable benefit) shall include all periods of employment with the Employer and/or such Affiliate.

This provision of the plan, therefore, does not delineate a specific policy regarding crediting of service between hourly and salaried credit, other than to make clear that all periods of employment should be credited for purposes of determining benefits under the Plan.

Finally, Mr. Engelhardt is contending that with respect to the Savings Plan, the Plan administrator furnished an incorrect prospectus regarding when amounts could be transferred among the various investments under that Plan. It is Mr. Engelhardt's belief that he relied on this erroneous prospectus to his detriment economic because. In fact, the Savings Plan and

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(footnote continued from previous page)
Under CESP A, August 20, 1986 (attached); also, copy of Article III of the Plan regarding Crediting of Service.

[5] Id.

the correct prospectus for that Plan provided for the movement of these funds prior to a time in which funds within one portion of the Savings Plan substantially declined presumably to the detriment of Mr. Engelhardt. A copy of the erroneous prospectus and Mr. Engelhardt's explanation of these events are attached for your review.[6]

I hope that the information that is enclosed will assist your office in an examination of practices by United Technologies under the Plan which may violate the requirements of the Code and the regulations. If I may be of any further assistance, or if you should need additional materials pertaining to these allegations, please do not hesitate to contact me.

Sincerely,

Roger J. Thomas

Roger J. Thomas

RJT:ms

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[6] See Attachment IV, copy of UTC's prospectus and Mr. Engelhardt's explanation.

UNITED
TECHNOLOGIES

Recvd 8/26/86 R.C.

August 20, 1986

To: Robert C. Christensen

Re: Benefit Calculation For Split Service Under CESP A

To confirm our discussion of August 13, 1986 with yourself and Stan, we agreed that when a participant has split service between CESP A and your Spectrol Hourly Retirement Plan, three types of calculations are performed. If an employee started on hourly and transferred to CESP A, the benefit he would receive is figured separately for each plan and for all Plan A service. The employee is charged for his hourly period and the salary piece is deducted against Plan A and any excess if the all service calculation is higher.

If an employee terminates his employment as an hourly participant and has salaried service, an hourly and salaried benefit are calculated without the CESP A all service. Furthermore, only the CESP A benefit can be paid out as a lump sum, the Spectrol hourly benefit is only paid as a monthly annuity due to the fact that the hourly plan does not provide a lump sum benefit.

The following cases should demonstrate the practices we are now implementing:

Case #1 10-1-54 to 9-30-58 hourly
10-1-58 to present salaried

We would calculate this benefit under CESP A all service since hourly did not have a pension plan until November 1, 1966.

Case #2 3-1-62 to 2-28-70 hourly
3-1-70 to present salaried

We would determine the hourly and salaried benefit separately and calculate a CESP A all service beginning from date of hire. If the CESP A all service is higher than the salaried piece, we would use CESP A all service and deduct the hourly benefit. For example:

Hourly Benefit	Salaried Benefit	CESP A All Service
$150.00 Monthly	$400.00 Monthly	$600.00 Monthly

The total monthly benefit would be $600.00, we would deduct $150.00 from the hourly plan and $450.00 from CESP A. ($600.00 - $150.00 = $450.00)

Case #3 12-1-60 to 11-30-68 hourly
12-1-68 to 11-30-74 salaried
12-1-74 to present hourly

We would determine an hourly benefit for both periods of service as an hourly participant and a salaried piece. There would not be a CESP A all service since the participant would terminate his employment as an hourly employee.

I hope this information will clear up any misunderstanding that a participant with split service may have in regards to their pension.

Bob

R. M. Solomon

RMS:bi

cc: L. A. Cavanaugh
S. J. Palasek
E. L. Storrs

UNITED
TECHNOLOGIES

RECEIVED
JUL 14 1987
PERSONNEL

April 15, 1987

To: P. B. Farnham
J. O. Garlock

Re: Change to the Carrier Employee Security Plan and to the Carrier Employees Savings and Investment Plan

Several changes have been made to the referenced plans to provide a uniform policy for transferred employees and to streamline some administrative problems. The changes are summarized in the attachment.

If you have any questions concerning these changes, please call me at extension 7818.

Larry
Lawrence K. Cavanaugh

LAC:kt
Attachment

cc: R. C. Baikal
D. J. Lint
D. P. O'Connell
S. J. Palasek
A. M. Williams

7/15/87
Solomon Says "lump sum"
under CESP.A will
p[illegible] may be eliminated
1-1-88 at Spect. et, tho not "official" yet

Carrier – lump sum eliminated
for retirements after 12-1-87

(RCC)

Chairman **Pickle**. Mr. Engelhardt, I wish we had received your testimony at the very beginning of this hearing rather than at the end.

It seemed like all the media is gone, and anybody that might take note of this to make it known to the country have departed.

It is very disconcerting that you have been trying to get information about your pension plan and just simply cannot seem to do it. All of this took place because of a takeover from Spectrol by United Technologies.

Mr. **Engelhardt**. The United Technologies purchased Carrier Corp. Spectrol is a wholly owned subsidiary.

Chairman **Pickle**. Yes. Now, when you went to United Technologies, you say they were arrogant and indifferent and just showed no interest at all in your case.

As you said, they said, that is tough, but that is the way it is. Then you went to the Department of Labor and the DOL said—finally in a letter you got back from them said that it's not their problem. They said they only monitor the plan at the IRS, the enforcement agency.

Mr. **Engelhardt**. That is right.

Chairman **Pickle**. Then, what is discouraging and startling is that you went to the IRS, and they said they did not have the time or staff to investigate your claim. They were just too busy and understaffed.

Can you document who you talked with at IRS and when they told you that?

Mr. **Engelhardt**. Yes; if you would like, I could read a list of agencies.

Chairman **Pickle**. Yes, I would like to have you submit that to us.

[The following was subsequently received:]

Date: June 25, 1990

To: CHAIRMAN J.J. PICKLE

From: Earl Engelhardt

Subject: YOUR REQUEST FOR ADDITIONAL INFORMATION

Dear Chairman Pickle,

Again, I want to sincerely express my thanks for the opportunity you have given me to present to you and your committee, the facts regarding the situation relating to the Carrier Employees Pension Plans and the United Technologies changes to those plans, after their acquisition of Carrier Corporation.

You asked me for the names of all those that I had dealings with as this situation unfolded over the last few years. These names are from my notes that I made during my investigation in an attempt to get help.Some calls were at random and others were directed to specific agencys that I believed responsible for my protection.

These are not in any specific order.

o CRIMINAL INVESTIGATION I.R.S.		213 894 4151
		213 468 3318
o TREASURY DISTRICT COUNCIL FOR THE I.R.S.		213 894 4660
o GENERAL LITIGATION		213 894 4672
o INSPECTOR GENERAL PENSIONS AND WELFARE DIV.OF THE D.O.L.		
	R. CURRY	
	BIRNBAUM	
	QUIGLEY	
	QUILAND	
o I.R.S.	MONICE ROSENBAUM	202 566 3422
o INSPECTOR GENERAL		213 251 7472
		415 251 7472
	STEVE BOLZ	
o LABOR RACKETEERING INVESTIGATING		415 556 0750
o TREASURY DEPT.	FRANK SPAZUKO	714 836 2101
o I.R.S.		213 894 0500
o DEPT. OF LAW INFORCEMENT		714 836 2301
o EMPLOYEE PLANS DIV.		213 894 4666
		213 894 4655
o DEPT. OF LABOR	JAN VANDERSTAY	202 523 8776
	DEBRA SILVER	202 523 8671
o IRS BENEFITS ASSISTANCE		202 566 6783
o TREASURY NATIONAL OFFICES		
	MICHAEL THARASHER	
o D.O.L. RETIREMENT EQUITY		
	JOHN MILLER	202 523 8776
o STAFF CONTRACT EMPLOYEE PLANS AND ACTUARIALS		202 566 6783
o D.O.L.	DAVID WALKER (LETTER)	
o CALIF. DEPT. OF FAIR LABOR		
	JIM HARRIS	714 558 4159

o		PHYLLIS	BORZI	202 225 5760
		CONGRESSMAN	CLAY	
		CONGRESSMAN	TORRES	202 225 5256
		ALMA	CANDELARIA	
		PHIL	ALPERSON	
		CONGRESSMAN	DREIER	818 339 9078
		JOAN	COUCH	
		MARK	HARMSEN	
o	A.A.R.P.	HORACE	DEETS (LETTERS)	202 872 4700
		CHRIS	MACARONIS	"
		ROB	LEIBROS	"
		ELLIOT	CARLSON	"
		JOHH	DOLAN	202 662 4194
o	A.C.L.U. OF LOS ANGELES			213 487 1720
o	C.B.S.	ARI	ALLEN	
	GREENSBURG TRIBUNE			412 834 1151
		RON	DEPARMA	412 838 5171
	WASHINGTON POST			202 334 6000
	WALL STREET JOURNAL			
		RICK	SCHMITT	415 986 6886
		PETER	WALDERMAN	415 391 4534
	NATIONAL ENQUIRER			
	SYRACUSE HEARLD			
		ADRIEL	BETTELHEIM	315 470 2259
	WASHINGTON TRIBUNE			
		CHRIS	DREW	202 785 9430
	LOS ANGELES TIMES			
	N.B.C.	JOHN	PALMER	
o	L.A.BAR ASSOCIATION			213 627 2727
	ORANGE COUNTY BAR ASSOCIATION			714 541 6222
	SAN DIEGO BAR ASSOCIATION			714 231 0781
	SAN BERNADINO BAR ASSOCIATION			714 888 6791
	ATTORNEYS AT RANDOM IN LOS ANGELES			
	BELL BOYD AND LLOYD IN WASHINGTON			
		ROGER	THOMAS	202 466 6300
	THE PENSION RIGHTS CENTER IN WASHINGTON			
		CARON	FERGUSON	202 296 3778

o	UNITED TECHNOLOGIES		(SENIOR EXECUTIVE MANAGEMENT)	
	ROBERT	DANIELL	CHAIRMAN AND C.E.O.	
	J.THOMAS	BOUCHARD	SENIOR V.P. HUMAN RESOURCES	
	RAYMOND	WILLIS	CORP.DIRECTOR RISK AND BENEFITS	
	ROBERT	MORRISSEY	OMBUDSMAN	203 728 6444
	MICHAEL	MICHAGAMI	PRESIDENT CONTROL SYSTEMS	
	ALEX	RODRIQUEZ	PENSION PLAN MANAGER	
o	SPECTROL ELECTRONICS CORPORATION			
	ROBERT	CHRISTENSEN	V.P. PERSONNEL RESOURCES	
	LLOYD	GOMEZ	BUSINESS MANAGER	
	AL	CRIPNER	HUMAN RESOURCES MANAGER	
	MARY	MCLEOD	PERSONNEL SUPERVISOR	
	ELISE	MONROE	HUMAN RESOURCE MANAGER	
	ROSALIE	LAMPSON	HUMAN RESOURCE SUPERVISOR	

I have extensive information to support my claims of the now many changes made by United Technologies to the Carrier plans prior to the sale of Spectrol.I want you to clearly understand my absolute willingness to share not only that with you,but also my years of experience and experiences during this period. I am sure that when the I.R.S. investigates U.T.C. they will uncover a multitude of horror stories just as was done when they were investigated for improper charges to military accounts.

Please do not underestimate the power and influence of U.T.C. They have enormous clout. Understand that I will do everything that I can and go anywhere to further expose U.T.C. for what they are doing. We have been sending the wrong message dating back to William Niskanan.I would like to be a part of correcting that unfortunate set of guidelines.

Finally, in an attempt to plan the ability to continue my efforts in the orginization of a class action law suit against United Technologies, regardless of the outcome of any I.R.S. decision or investigation,will you assist me in getting a list of names for anyone with entitlement to the Carrier pension and benefits programs from U.T.C.? I believe I could then get enough contributions to support the cost of litigation. At the least,I would have the opportunity to be able to try to continue this long uphill fight against U.T.C.

Thank you again for allowing me to be a part of your investigative action to resolve this injustice.

Sincerely;

cc: FILE COPY
ROGER THOMAS

6-20-90

To Chairman: J. J. Pickle
House ways and Means Oversight Committee.

Re: Earl Engelhardt / United Technologies / IRS-DOL

I was responding to a request by the Washington Post to put together a package of information so they could do an article about this situation when I ran across a letter that I dont believe I had given you, nor was the name on my subsequent list to you. Sorry for this late information, but this document really spells out the responsibility of the D.O.L. and the I.R.S. in this issue according to Richard Small, Chief. Div of Technical assistance and inquiries, and I therefore thought you would be interested.

If I can be of any further assistance don't hesitate to call.

Sincerely

Attachment A-4 of 5 Earl Engelhardt

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210

APR 7 1988

Dear Mr. Engelhardt:

The Department of Labor shares responsibility for the administration of the Employee Retirement Income Security Act of 1974 (ERISA) with the Internal Revenue Service (IRS) and the Pension Benefit Guaranty Corporation. ERISA is intended to provide protections and guarantees for participants and beneficiaries covered by private pension benefit plans. ERISA sets minimum standards which pension plans must satisfy with regard to such matters as employee eligibility to participate, vesting, funding, fiduciary responsibility, and reporting and disclosure.

The IRS has the authority and responsibility to administer United States tax laws, including those related to tax qualified plans. In addition, the IRS has primary jurisdiction over the ERISA participation, vesting, funding and benefit accrual provisions. The IRS is also responsible for determining whether there has been a complete or partial termination of a pension or profit sharing plan.

Since it appears that the issues raised in your inquiry are within the primary jurisdiction of the IRS, you should write to the Employee Plans Division of the Office of the District Director of the IRS nearest you for such assistance and technical information as they are able to provide. The letter to the IRS must include the employer's name and address, the name of the plan if possible, and information indicating that you may be entitled to benefits under the plan.

I hope this information will be helpful to you.

Sincerely,

Richard Small
Chief, Division of Technical
Assistance and Inquiries

Chairman Pickle. Now, you went on and from there you couldn't even get a class action filed because no attorney wanted to fool with it, and AARP said that you should get an attorney, but not them, to get somebody else.

But apparently you did find somebody in Mr. Thomas. Is he with AARP?

Mr. Thomas. Mr. Chairman, good afternoon.

No, I am a private attorney with the law firm——

Chairman Pickle. Will you identify yourself.

Mr. Thomas. Yes. My name is Roger Thomas. I am a partner with the law firm of Bell, Boyd, & Lloyd.

Chairman Pickle. You are a law partner with whom?

Mr. Thomas. Bell, Boyd & Lloyd. It's a large, private firm.

Chairman Pickle. All right. Well, now, Mr. Engelhardt, have you—after all this procedure, have you found out anything about your pension plan? Do you have a plan? Has it gone under? Is it protected? Is your money secure, or do you know?

Mr. Engelhardt. Yes, there is a pension plan. Is it secure? I guess that is a matter of opinion. I think that this what the hearing is all about. I am quite concerned with security.

The financial condition of the plan, I believe, is sound, and we have received some verbal and I have received some written statements about my entitlement of—as a matter of fact, I have received four statements so far of which the last one is still not correct because it does not have a 1986 tax law consideration.

Chairman Pickle. Well, I am trying to establish, Mr. Engelhardt, if your pension is secure, if the funds are there for you, in spite of the takeover and the change of plans, are the rights that you were promised originally being protected now; do you know?

Mr. Engelhardt. No. In fact, I really don't know that for sure.

Mr. Thomas. Mr. Chairman, the problems that Mr. Engelhardt and the other participants of the two plans of Spectrol are very specific. They involve lump sum benefits which are presumably protected by provisions of the code and the regulations. They involve the determination of hourly service and salaried service under the terms of the plan.

There is an outstanding question as to the valuation of stock that was in a stock plan of the fund, which significantly depreciated after Black Monday and the collapse of the stock market.

There is additionally a statement by the company that the retiree health benefits of certain workers would be contracted after a specific date and time.

Now, each of these involve, I would imagine, a substantial amount of benefits. The question may not be whether the fund is necessarily liquid. I think the concern is that Mr. Engelhardt and others have a concern that they may have been deprived of benefits which should be protected under the terms of the plan and the code.

Mr. Schulze. Will the gentleman yield for a question?

Chairman Pickle. Yes.

Mr. Schulze. My understanding is that they cannot change benefits retroactively, but you have not said that they have.

Did they change any benefits retroactively?

Mr. Engelhardt. As a matter of fact, I believe they have.

Mr. SCHULZE. Am I correct in the law that you cannot change benefits retroactively?

Mr. ENGELHARDT. My understanding of the law, from everything that I have read of the Internal Revenue Code—REA and ERISA, it clearly states that you cannot retroactively reduce benefits.

In fact, the Department of Labor publication clearly states to the fact that you cannot retroactively remove them, nor can you remove what is called a valuable right.

And I believe that the valuable right addresses mortality. Maybe Roger can help there.

Mr. SCHULZE. Did they try to notify the participants in the program of these changes, or did they not even attempt to do that?

Mr. ENGELHARDT. In the case of lump sum, they, in fact, made a series of notifications starting with Carrier—let me tell you a little bit about Carrier.

Carrier Corp., of course, is a huge company and was taken over by United Technologies. Carrier is made up of a series of other companies, many of which are under the Carrier retirement and benefits plans. So there are many different things involved in the Carrier plan systems.

Now, I have lost track of the question.

Mr. SCHULZE. Did they try, or did they notify the participants?

Mr. ENGELHARDT. Essentially, in the case of the lump sum, yes, we were, in fact, notified that it would end; and providing we meet what they called the provisions of the plan by a certain date, that we would be entitled to the lump sum.

I had, I believe, 30 years in the plan at that time and thought I was entitled to that. But they said no, that you had to meet it by a certain date.

So that was the notification. One of the other things that they—United Technologies—did is they changed the service measurement of employees in the Carrier plan. In the Carrier plan, the service measurement is—has an effective date essentially, which is based on your date of hire—the plan calls it "employment or reemployment date"—as I read the plan.

The United Technologies Pension Committee chose to interpret that differently. They took a longstanding practice that Carrier had been using to measure your total length of service, to the measurement of service of using your hourly time in an hourly plan and your salaried time in a salaried plan, which would greatly reduce the benefits for employees that had both hourly and salary time.

There is a lady that brought this to my attention about 7 years ago when this whole issue started. Her name was Millie Fastrup. She had received a pension lump sum preestimation of retirement benefits from the Carrier Corp. Pensions and Benefits Committee.

She was planning to retire, of course, from Carrier Corp. And then United Technology took over the company and she asked for her final benefits as a lump sum, which she at that time was still entitled to, because they hadn't ended the lump-sum provision in the Carrier plan.

Her lump sum went from some $42,000 to, I believe, $12,000 because of the change of service measurement based on hourly and salary time as calculated by the United Technologies Pension Committee. And when we went back to ask why that happened, we were told essentially that is not the way we do it at United Technologies. This is the way it is.

Mr. Schulze. I thank the gentleman for yielding.

Chairman Pickle. Well, Mr. Engelhardt, it seems to me that you have had a very difficult time finding out what your pension rights actually are. And almost everywhere you turn, it seems to me like the Federal Government is saying to you, go see somebody else.

And you have, as an individual, had a very difficult time finding out what are your rights. Now, I am not trying to pass judgment on whether your case, or whether the United Technologies takeover has affected your rights, but you are trying to get information—and you are still trying to get information, and you don't know about it.

You finally, I assume, in some desperation have hired your own attorney, and he is trying to find out what you think are your pension rights, because they don't want to make a settlement.

Now, let's assume that the facts are established and you finally get information that your rights are protected. At that point, do you owe Mr. Thomas for legal fees?

Mr. Engelhardt. As of right now?

Chairman Pickle. If you do, say, win, then United Technologies, will they pay your legal fees, or will anybody else pay your legal fees?

Mr. Thomas. Mr. Chairman, ERISA contains what is called a fee shifting provision which enables at the discretion of a court judge to have, for example, a prevailing plaintiff awarded attorneys fees in a particular case where it is merited.

Now, one of the difficulties that many, many participants have, as experienced by Mr. Engelhardt, is simply finding a plaintiff's attorney who is willing to take the case.

This is a situation involving very discreet interpretations of the code. It's considered an interpretive question.

In point of fact, there is one provision of a regulation of the IRS which would seem to contravene, in my opinion, the intent of the statute in terms of protecting lump sum benefits in a preamendment status.

The cost of private representation, as you are probably painfully aware, is highly expensive. I have been able to do the work for Mr. Engelhardt on a fairly limited basis, but I think his situation and my ability to do that is highly unusual.

Many attorneys are not in the position, because of the limited return or the fact that they may not receive attorney's fees, they are simply not in a position to provide legal services from these firms.

Chairman Pickle. Well, is there any place within the Federal Government, whether it's the PWBA, whether it's the solicitor general's or the IRS or the DOL, that an individual can go to get information about his own rights and his own protection?

Can he call up anybody to say, can you tell me whether my pension is sound or not?

How does a little fellow like Mr. Engelhardt go about trying to just get facts from the parties concerned? He is just an individual working for this company, and you worked for what, 30 years, or thereabouts?

Mr. ENGELHARDT. I have almost completed 36 years now.

Chairman PICKLE. 36 years. And yet no where in the Government can anybody seem to tell you what your rights are.

And then in view of the fact that you finally in desperation hired an attorney, and you are trying to find out what your rights are, then I guess the question will still be open, who pays the attorney's fees?

Not many people will keep on pursuing their rights, and even if you are successful, it leaves the question about huge legal fees.

This kind of situation bothers us because there just seems to be no help. And it seems to be typical of the great difficulty I think the average person has in just finding out their rights and getting information.

I think that is what bothers this committee. How can we get information to the average pensioner so he can get information about his own plan?

Somewhere along the line, that ought to be done, and I don't see how to do it. But we may be following through, Mr. Thomas, to you with additional questions for additional information. We would like to see what does happen on this case and how information is being obtained.

Do either of you have any additional statement to be made at this point?

Mr. THOMAS. No, I don't. But I would like to respond just for a moment to your last statement.

I, first of all, want to compliment Mr. Engelhardt, because I think he is an unusual individual. He is highly intelligent. He has aggressively pursued obtaining what he views to be his rights under the terms of the plan.

Your average plan participate is not necessarily going to be well situated to defend and pursue his claims, as Mr. Engelhardt has been. I think there is a tremendous need for the agencies to do more in being responsive to the inquiries from individuals like Mr. Engelhardt and others.

You know, there is a vast population out there who have concerns regarding their retirement security. Questions come up, plan changes occur, and it seems to be, for whatever reason, very difficult for many of these individuals to receive guidance from the two agencies which are responsible for the protection under ERISA.

Chairman PICKLE. I believe Mr. Schulze has a question.

Mr. Schulze.

Mr. SCHULZE. Thank you, gentlemen.

I will try to be brief, because we are drawing to a close.

My first question is, is there a union involved? Is there a union, and were you a member of a union?

Mr. ENGELHARDT. Where I am employed there is no union.

Mr. SCHULZE. There is no union?

Mr. ENGELHARDT. No. But there are unions in other divisions of Carrier plants.

Mr. SCHULZE. Are those unionized operations receiving the same type of treatment?

Mr. **Engelhardt**. I don't know that. When I first started my involvement in this, I tried advertising through papers in cities where other Carrier divisions existed. One, of course, is Syracuse, N.Y. I had very minimal response.

The people that I did talk to, of course, were quite fearful of any attack on United Technologies. But I did write a letter to the union that represented a majority of workers in Syracuse, because I found there were some of the Carrier divisions that seemed to have salary and hourly plans that were nearly identical.

I was never able to get a response from any union official at Carrier in Syracuse, N.Y. I mean, literally, they wouldn't talk to me. So I don't know what the circumstances are.

All I know is that this was my experience with it. In my dealings around the country, though, where I have taken out the ads and received responses from a few people, I have found a great many people that have tried unsuccessfully to get problems resolved with United Technologies about discrepancies in their pension benefits.

One of which I remember quite clearly was a woman that was trying to get her time bridged. It was—she had left the company and returned, and had a letter from Carrier stating in fact, she believed that her retirement was bridged and then wanted to collect her benefits.

And they—the United Technologies Pension Committee—said, no, I am sorry. We don't read the plan that way. One other fellow was trying to get his last raise in salary, which is a function of the retirement calculation formula, into the pension formula calculation and had no success. He tried for 1½ years and was unsuccessful.

But those are not uncommon stories. When an individual tries to go after somebody like United Technologies to get something corrected, it's really a nightmare. It's not possible.

Mr. **Schulze**. I don't want to jump to a conclusion, but Mr. Thomas, I would like your opinion. It sounds to me on the surface of what I have heard that this is a fairly sophisticated attempt to either reduce those benefits or make more money available, as excess funds in that pension plan. And if so, it's a cause of quite some consternation.

Mr. **Engelhardt**. Yes. I would really like to respond to that for just a second.

When I first started in this whole thing, it was back at a time when companies were being acquired and pension plans were being essentially dissolved and taken to profit and all those other kinds of things. And I was quite afraid that that is what was going on here.

So—just a moment.

Mr. **Thomas**. Mr. Schulze, let me respond to your inquiry, because I think it's a very important one.

Yes, the interpretations that were provided by United Technologies regarding, particularly the split service, the accounting of hourly time and salary time is quite sophisticated. In fact, it's unique.

In our review of the case law, we have found no cases which really treat this problem. It would appear to be a violation of

1054(g) of ERISA and provisions of the code in terms of reducing an accrude benefit of a participate covered under a plan.

But here it was not done by amendment. It was done by simply changing the interpretation of the terms of the plan.

In that instance, I think it's again extremely important to have the purview of the IRS as to whether or not this is a permissible amendment or not.

Mr. SCHULZE. When they did that, they did notify?

Mr. THOMAS. Mr. Schulze, I prepared on Mr. Engelhardt's behalf an opinion letter describing in great particularity what I view to be potential violations of certain provisions of the Tax Code and conceivably ERISA.

That letter was sent on September 20, 1988. To that date, we have not received a response.

[The following was subsequently received:]

United Technologies made no effort to formally notify any plan participants about the change of measurement to people that had both hourly and salary time. Nothing in writing was ever given to the people in the plan, even after the decision to "streamline" the plan was made. Refer to memo from Lawrence Cavanaugh, Re: "Change to the Carrier Employee Security Plan and to the Carrier Employee's Savings and Investment Plan" dated April 15, 1987, and memo from R. M. Solomon, Re: Benefit Calculation for Split Service under CESP-A dated Aug. 20, 1986. (Attachment III to Vincent Rotolo of the Brooklyn I.R.S.)

Mr. SCHULZE. Well, please keep us informed as to the progress. Perhaps we could drop a line here and there to see if we can find, or jog some people to get some information, as well.

Mr. ENGELHARDT. Just briefly, I would just like to finish up where I lost my thought there for a moment.

The changes that United Technologies seemed to be going through, to me, were to realign all of the benefits and the application and the administration of the benefits, of the Carrier employees plan to mirror the United Technologies' plans.

In effect, the United Technologies' plan had no lump sum. In effect, they administrated the United Technologies' plan as hourly time and so forth. Those two plans became similar, if not identical.

And it is my belief, had not all of this come up, and I not been so vocal bringing to light about the other changes being made by United Technologies, it is certainly my belief that they would have had sufficient funds in the United Technologies' plan to mirror the two and marry them and dissolve the Carrier pension plan.

I don't know that in fact, but that certainly could happen.

Another thing that I am quite afraid of is the fact that in the treatment of people, apparently there is a way that they can provide to us an insurance annuity, as what they believe is an equivalent to my pension benefit and, of course, an insurance annuity is not an equivalent because it's not protected by Federal law.

It's only at the mercy of the insurance company, and if you think about the conflict of interest that might go into the fiduciary/employer relationship when they are trying to establish and pay an insurance company to take on these benefits, it's clearly not in my favor. And I would be terribly afraid of that.

Mr. SCHULZE. One final question, Mr. Engelhardt. Did you take time to sit down and figure out whether an employee with 35 or 40 years under Carrier, if he had gone to his ultimate retirement point, would receive the same or more than an employee under exactly similar circumstances under United Technologies, for the same period of time?

Mr. **ENGELHARDT**. I think, considering the new rules that they have where they directly changed the hourly salary relationship that the benefits could be reduced by 70 or 80 percent quite easily.

Mr. **SCHULZE**. So that the benefits would have been 70 or 80 percent higher under the original Carrier program than they would have been for similar employee under United Technologies?

Mr. **ENGELHARDT**. Yes, I believe that that is true.

Mr. **SCHULZE**. OK.

That is probably their motivation then for——

Mr. **ENGELHARDT**. Oh, of course. All of this was planned to reduce or eliminate benefits to plan participation. Everything that has happened in relationship to these plans, whether it's health benefits or service measurement or lump sum or whatever is always stacked in United Technologies' favor. They want the money.

Mr. **SCHULZE**. If you could merge some plans, you could simplify bookkeeping. You could increase the efficiency and so forth. But where there is a difference like that, I would doubt if the motivation was essentially as much as it was——

Mr. **ENGELHARDT**. Considering the fact that I received essentially four statements from United Technologies, three of them at least are computer readouts.

I believe what they have done is they have mirrored the plans into a computer program of some sort to make the calculations easy, because it's a purely mathematical function.

So in doing that, in order to make the plans administrable through this program that they have, they had to make them mathematically the same. And they essentially, I believe, degraded the Carrier plan in order to do those things.

Now, of course, they have said that they, in fact, have not degraded the plans; they have a gal, Peg Harsham or Hasham or something that is a spokesperson for United Technologies, and she said publicly that we—United Technologies—have not degraded the Carrier plan since United Technologies took over Carrier.

And I don't agree with that a bit. And there is some other things that they have said that are not true.

[The following was subsequently received:]

My reference is to United Technologies Control System President Michael Michagami's memo to employees and "dialog" answers stating that the lump sum provision never existed in the provisions of the Carrier plan, which of course is not true either.

Mr. **SCHULZE**. Thank you both, gentlemen.

Thank you, Mr. Chairman.

Chairman **PICKLE**. Well, Mr. Engelhardt, I imagine your case is similar to thousands of other people across this country who are wondering what are my rights, whether there has been a takeover and change from the original plan.

And I would like to say the fact is that there is not a place to go to get a fair answer. You apparently have tried, and all the agencies have said, well, you contend one thing and your plan sponsor contends something else. And they say, go to court. This is not a case of a violation of some fiduciary procedure but rather a question of benefits, what are you entitled to. Your company now says that you are entitled to so much, and you question that.

And you, therefore, are going to an attorney to say, no, I am entitled to more. So now you have got to prove it one way or another.

Now, our committee is trying to determine, is this the legal procedure we should expect that we should follow, or is there some better way to get information from the various parties.

We are not passing judgment on whether any companies along the line have changed the plan or not given you the correct benefits. But you still cannot get the information, and the only way you can get it now is if you go to court.

That is why we are looking into this case, just because we think it's a little different from the other cases. It's not a matter that the plan sponsors and fiduciaries are making violations.

So we will proceed with this case, because we think it's an interesting situation, something we ought to look at.

Now, Mr. Thomas, did you want to say anything else?

Mr. THOMAS. Yes, Mr. Chairman. I would like to respond to your last statement regarding the potential for litigation.

Mr. Engelhardt has strenuously endeavored to collect a sufficient sum to meet the retainer requirement that our firm has proposed. He has not been successful to date because he just simply has not been able to collect sufficient funds.

So I think there is a substantial question, unfortunately, as to whether or not we are going to be able to proceed with litigation, because of the inherent cost.

So I would suggest to you that in the benefit claims area, unless the Department of Labor or the service effectively intervene to monitor or determine again many, many participants are simply not going to be in a financial position, a knowledgeable position, to effectively protect their claims.

There is no intermediary administrative apparatus to adjudicate claims in this area.

Chairman PICKLE. Well, I think I recognize that there is no clear procedure to follow.

I thank you very much, Mr. Engelhardt, for coming here today and presenting this analysis and your concerns. I appreciate it.

The committee will now stand adjourned, until 9:30 in the morning in this same room.

[Whereupon, at 1:55 p.m., the subcommittee adjourned to reconvene at 9:30 a.m., Wednesday, June 13, 1990.]

ENFORCEMENT AND ADMINISTRATION OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

WEDNESDAY, JUNE 13, 1990

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, D.C.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

Chairman Pickle. The subcommittee will please come to order.

Yesterday we spent 5 hours reviewing six specific ERISA cases. Based upon the testimony we received, it is clear to me that the 200 investigators at the DOL cannot possibly handle the 900,000 employee plans that exist today. I have to say that the present level of the Federal enforcement of ERISA is unacceptable.

Workers covered by pension plans in this country depend upon the Federal Government to protect their benefits. This was the reason that Congress enacted ERISA. ERISA provides strict rules governing the operation of employee benefit plans and a system of civil and criminal enforcement for those who break the law.

This system, ERISA, protects the retirement savings of 76 million workers. Plan assets exceed $1.7 trillion. This is the biggest pot of money in the world. So we have to recognize there is a lot at stake. The Federal Government needs to think smarter, work smarter and have the resources to be there for the American worker.

In view of the hearings yesterday, I want to ask some general questions now of our panelists and witnesses today. Let me first start by saying to you, what do you say to the pensioner who suspects that his pension plan is being ripped off? Do you say, "Everything looks good on paper; the form 5500 has been filled out; the proper paperwork has been filed; don't worry."

What do you say to the pension beneficiary who has just lost all his retirement savings? Do you say, "Sorry about that."

What do you say to pensioners who receive their benefit checks and find that they have been shortchanged? Do you say, "Go get a lawyer."

Finally, the subcommittee needs to know how decisions are made with regard to civil versus criminal prosecutions. If a plan trustee steals money from a pension plan and replaces it, is he off the hook for criminal violations? Specifically, should we put greater emphasis on criminal prosecutions?

In my part of the country, we used to say a good hanging does more for cattle rustling than anything else. Does pension management really only worry about civil penalities? Have we caused too many plans to be canceled or cashed out because of regulations?

It doesn't look like the Government has a good answer to any of these questions, and they are very complex. In many instances, I would have to say, if I were a pensioner who has been damaged by fraud or abuse or neglect, I think I would just have to shake my head and say, thanks por nada.

We can all do a better job, and that is why we are holding these hearings.

The panel today and the witnesses today are going to be very important to us in our further consideration.

Now, the Chair would like to yield to Mr. Schulze for any statement he might make.

Mr. SCHULZE. Mr. Chairman, I am pleased to join you in opening our second day of hearings on ERISA enforcement issues. Yesterday the subcommittee reviewed the case histories of pension plans which have failed. The failures were not the result of simple bad luck. The failures often were the result of bad pension managers and speculative investments.

Today the subcommittee will hear from the Federal agencies responsible for enforcing the ERISA safeguards, which are supposed to protect pension plan assets. We know from yesterday's testimony that the safeguards do not always work.

The subcommittee hearing has a dual objective. First, we should evaluate how the current ERISA provisions can be administered more effectively to reduce the risk of pension plan failures, and second, we should evaluate what improvements to ERISA might be desirable to strengthen the hand of the pension enforcement team. We want to make sure that the Federal agencies are responsible watch dogs and not just lap dogs.

The typical pension plan participant believes his benefits are safe because they are in a trust fund governed by Federal regulations. In reality, most pension plan assets are safe because they are managed by honest persons making responsible investments.

The ERISA enforcement provisions are directed at the managers who might be tempted to misuse their power. Mr. Chairman, I am anxious to hear our witnesses today discuss how they enforce the ERISA pension safeguards.

Chairman PICKLE. I thank you, Mr. Schulze. Do any other members of the committee have opening statements?

Mr. CHANDLER. Mr. Chairman, if I could just make a very brief comment.

Chairman PICKLE. Mr. Chandler.

Mr. CHANDLER. What we heard and saw in the committee yesterday reminds me a great deal of when I was a television journalist back in the late 1960's and 1970's. I was very often asked by people why don't you do any good news, why don't you focus attention on the thousands of people who don't commit crimes and who behave themselves and go to work and pay their taxes and so forth.

Well, the answer is a pretty easy one, because people don't watch news casts like that. There isn't any interest in that kind of thing. While they may get sick and tired of watching TV news casts every night about all the crime and corruption and you begin to get the idea that that is all that exists. If they didn't have that on TV every night, they wouldn't watch very much of it.

The only reason I raise this point is that I want this committee and those who are watching its activity to be aware that we are dealing here with a serious problem, but we are also dealing with the exception.

Our response to what we learn here is going to be a very important one in the ongoing management and the offering of pension benefits to workers in the United States. I have said before, and I am going to say again, until people are sick of hearing it, I believe if we are worried about people being without benefits in a pension plan, then we ought to look to what Congress does to discourage the offering and the continuation of pension plans every bit as much as we do to the rare individual or plan sponsor which violates the law and the trust of those people for whom those benefits are made available.

So I am simply making these comments in the spirit of suggesting that I admire you, Mr. Chairman, and the work that you are doing here. But I want the public to understand that when we talk about someone actually stealing benefits, that is a rare, rare, rare case. What is perhaps more important in this whole equation is the fact that there are far more pensions being terminated because of expense, and because of complexity, than there are people losing their benefits because someone has stolen the assets of a plan.

Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Chandler.

Our first witness this morning will be Mr. Joseph Delfico, who is the Senior Associate Director for the General Accounting Office.

Now, Mr. Delfico, if you will proceed with your statement. Your entire statement will be included in the record. Will you identify the gentleman with you at the table.

STATEMENT OF JOSEPH F. DELFICO, DIRECTOR, INCOME SECURITY ISSUES, HUMAN RESOURCES DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JOHN HANSEN, ASSIGNMENT MANAGER, HUMAN RESOURCES DIVISION, AND DAVID CLARK, ASSOCIATE DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION

Mr. DELFICO. Thank you, Mr. Chairman.

With me is David Clark and John Hansen, both of whom helped prepare the statement and will be available to answer questions you or other members may have.

I am pleased to be here today to discuss the oversight of pension and welfare benefit plans by the Internal Revenue Service and Department of Labor.

IRS and Labor are responsible for ensuring that pension plans and welfare benefit plans comply with the Employee Retirement Income Security Act of 1974, ERISA. Their efforts have a significant impact on ensuring that plans are free of mismanagement, fraud and abuse that place assets at risk and threaten plan participant benefits.

In addition to the security of benefits, of particular concern to us is the effectiveness of Federal oversight in reducing the Government's potential exposure to underfunding in pension plans insured by the Pension Benefit Guaranty Corp., and estimated to be between $20 and $30 billion.

Today, I would like to provide our preliminary observations on two areas you specifically requested us to assess, the effectiveness of IRS's and Labor's ERISA enforcement programs. I will also provide GAO's views on Labor's proposals to enhance ERISA enforcement by strengthening IPA audits.

IRS enforces ERISA vesting, participation, and funding provisions by reviewing plan designs and examining plan returns and operations for compliance with tax laws and regulations.

IRS's ERISA enforcement program is conducted by about 1,000 Revenue agents. This represents 83 percent of the combined staff resources available at IRS and Labor for the oversight of ERISA. IRS directs 55 percent of its resources on plan examinations and 45 on reviewing plan designs.

Although IRS allocates over half its resources to examinations, most of the resources are spent examining defined contributions plans that pose no risk to the Government's pension insurance program. In addition, while its future work plans will increase defined benefit plan examinations, much of the focus will be on small, overfunded plans that pose little risk to PBGC. Though these efforts may produce additional tax revenue, we believe IRS should work to better balance their targeting strategy and allocate enforcement resources to also ensure that participants' benefits are protected and thus reduce the risk to PBGC.

With regard to IRS's targeting strategy, IRS is finding violations in far fewer examinations than expected. It is using outdated criteria to identify plans with characteristics that indicate a high potential for ERISA violations. IRS plans to implement an alternative selection system this year that it hopes will enable it to make more quickly and accurate target plans with high potential for ERISA violations. While this approach may be preferable to past methods, we believe IRS should include criteria in their model that will also target plans that pose a potential risk to the Government's pension insurance program.

Another concern of ours relates to the quality of IRS examinations. Historically, IRS reviews district office operations in part to ensure that enforcement programs are effective and examinations meet IRS's quality standards. However, IRS suspended this program in 1985. At the 3 offices we visited, only 29 examinations had been reviewed from 1987 through 1989 to ensure that they were sufficiently thorough to identify ERISA violations. We are encouraged, however, that IRS recently initiated a quality assurance program that will review each district office's employee plan operations, including a review of the quality of examinations every 2 years. If properly implemented, this program could help ensure the examinations are sufficiently thorough to identify ERISA violations.

My final comment on IRS deals with approving plan designs. IRS expects to receive many requests from plans to approve plan design changes made to comply with the Tax Reform Act of 1986. To meet this demand and continue to devote most of its ERISA enforcement resources to examinations, IRS made several changes to reduce the time spent reviewing plan designs. Although we are encouraged that these changes may free more resources for examinations, we are concerned that these changes may result in some plans receiving approval for changes in plan design that do not comply with ERISA. To determine the extent of this problem or if there is a problem at all, we believe IRS should evaluate the impact of these changes periodically.

The Department of Labor focuses its enforcement efforts on conducting investigations to ensure that plans comply with ERISA's fiduciary provisions and are operated in the best interests of the participants. Labor is also responsible for enforcing ERISA's reporting and disclosure provisions.

Labor adopted a new enforcement strategy that allocated 50 percent of its enforcement resources toward investigations of financial institutions and welfare plans service providers that Labor characterized as having high potential for fiduciary abuse. However, the results of the new enforcement strategy have been disappointing. These investigations find fewer violations and take twice as long to complete as individual plan investigations.

With regard to targeting plans for review, Labor and IRS have made substantial progress in improving the quality and timeliness of plan annual report data that are essential to effectively identifying violations.

Labor has also developed a computerized system to use the improved data base to target plans, financial institutions, and service providers for investigation. Despite this progress, we are concerned that the system may miss the plans with significant weaknesses. Certain data in the annual reports reflecting the funded status of defined benefit plans are not included in the system data base for 1988 plan returns, the first year to be included in the improved data base.

As a result, Labor cannot identify underfunded defined benefit plans for investigation. This information is critical to ensuring that these plans have not committed ERISA violations that may place plan assets and participants at risk and that they do not end up becoming liabilities to PBGC and the taxpayers.

Perhaps the most important enforcement issue and the most difficult to deal with is the question of the adequacy of enforcement resources.

Labor has an ERISA enforcement staff of about 200 or about 1 for every 4,500 pension plans. At this staffing level, Labor investigates less than 1 percent of the plan universe each year. Labor's fiscal year 1991 budget requests 133 additional staff members for ERISA enforcement. Although this increase, if approved, is a step in the right direction, it is unclear whether the additional staff, combined with the improvements in targeting mentioned earlier, will be enough to ensure that Labor can provide an effective deterrent to ERISA violations.

The small amount of Federal resources available to enforce ERISA heightens the importance of annual plan audits by independent public accountants.

ERISA requires administrators of employee benefit plans with 100 or more participants to engage an independent public accountant (IPA), on behalf of plan participants, to conduct an annual audit of the plan's financial statements.

Recent proposals by Labor to strengthen ERISA's independent audit requirements would, in our view, improve ERISA oversight and enhance the security of participants and we encourage service consideration of that.

We agree that full scope audits should be required for employee benefit plans and that serious considerations should be given to requiring mandatory peer reviews for all auditors of insured plans.

We also believe that auditors should be required to review and report on plan management assertions regarding the effectiveness of its internal control structure and compliance with the laws and regulations, in addition to reporting on the plan's financial statement.

Labor should also be informed, particularly of major fraud or serious fiduciary violations, directly and promptly.

Mr. Chairman, we are continuing our work at IRS and Labor and will soon initiate work at PBGC to focus on ERISA issues. We currently have a financial audit of PBGC underway. As our work progresses, we will be briefing your staff on our findings.

This completes my statement, and I will be happy to answer any questions you may have at this time.

[The prepared statement follows:]

STATEMENT OF JOSEPH F. DELFICO, DIRECTOR, INCOME SECURITY ISSUES, HUMAN RESOURCES DIVISION, U.S. GENERAL ACCOUNTING OFFICE

I am pleased to be here today to discuss the federal government's oversight of pension and welfare benefit funds.

The Internal Revenue Service (IRS) and the Department of Labor are responsible for ensuring that pension plans, with about $2 trillion in assets, and welfare benefit plans comply with the Employee Retirement Income Security Act of 1974 (ERISA). Their efforts have a significant impact on ensuring that employee benefit plans are free of mismanagement, fraud and abuse that place plan assets at risk and threaten plan participants' benefits. The effectiveness of their oversight also influences the potential for losses by the government's pension insurance program, administered by the Pension Benefit Guaranty Corporation (PBGC).

Of particular concern to GAO is the effectiveness of federal oversight of employee benefit plans that are essential to the well-being of millions of Americans, and the government's potential exposure to underfunding in pension plans insured by PBGC, estimated at between $20 and $30 billion in specific large plans.

GAO has a number of efforts underway in this area. These include a financial audit of PBGC and a review of recent criticisms made by Labor's Inspector General of the quality of independent public accountant (IPA) audits of large employee benefit plans.

Today, however, I would like to provide our preliminary observations on two areas you specifically requested us to assess--the effectiveness of IRS' and Labor's ERISA enforcement programs. I will also provide GAO's views on Labor's proposals to enhance ERISA enforcement by strengthening IPA audits.

IRS'S ERISA ENFORCEMENT PROGRAM

One of IRS's primary missions is to enforce ERISA's vesting, participation, and funding provisions. It accomplishes this by (1) reviewing plan designs and (2) examining pension plan returns and operations for compliance with tax laws and regulations. Although IRS has increased its examinations of plan operations, we have questions about the effectiveness of its ERISA enforcement program.

Enforcement Resources Not Focused on Underfunded Plans

IRS's ERISA enforcement program is conducted by about 1,000 revenue agents in 7 key district offices nationwide. This represents about 83 percent of the combined staff resources available at IRS and Labor for the oversight of ERISA.

Historically, most of IRS's ERISA enforcement resources had been spent on reviewing plan designs, rather than examining plan operations. This was because of the newness of ERISA and frequent changes in the law that required plan amendments. In a March 1979 report,[1] we concluded that IRS had made little effort to determine that plans were operating in compliance with ERISA, because most of its resources were spent reviewing plan designs.

IRS subsequently increased the number of pension plan examinations it conducted annually. However, between 1980 and 1986, examinations fluctuated from about 18,000 to about 28,000 because changes to ERISA required resources to be allocated to reviewing changes in plan designs. When examinations fell to about 5,000 in 1987, IRS decided that the number of plans examined was too low to ensure a high degree of voluntary compliance with ERISA. As a result, IRS redirected its resources so that 55 percent would be spent on examinations and 45 percent on reviewing plan designs.

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[1] Internal Revenue Service Efforts and Plans to Enforce the Employee Retirement Income Security Act (HRD-79-55, Mar. 28, 1979).

Although IRS has directed more resources to examinations, it devotes significant resources to examining plans that pose no risk to the government's pension insurance program. For example, in the last 2 years, IRS devoted 65 and 68 percent of its examination resources to defined contribution plans that pose no risk to the government because, unlike defined benefit plans, they are not insured by PBGC. Defined contribution plans have represented 62 percent or more of IRS's total examinations during the last 5 years. IRS field staff told us that these examinations have been emphasized because they are easier for inexperienced agents to perform.

IRS intends to increase the number of defined benefit plans it examines during the next few years as part of a special revenue initiative focused on plans with fewer than 5 participants. This initiative is expected to generate up to $800 million in additional tax revenue through 1993 by disallowing plan sponsors' tax deductions for plan contributions that IRS believes exceed ERISA's funding limitations. In contrast, IRS's work plans place little emphasis on examining plans that are or may be underfunded and pose a risk to participants and PBGC.

Although IRS's special emphasis on small overfunded defined benefit plans is expected to produce significant revenues, using resources for this effort limits those available to examine plans that may become liabilities of the PBGC. This raises a question regarding the inherent conflict between IRS's major missions. While revenue-raising initiatives should not be discouraged, IRS should determine how to better allocate its limited ERISA enforcement resources to also ensure that participants' benefits are protected and thus reduce the risk of plans becoming liabilities to PBGC.

IRS Needs to Improve Its Examination Selection Procedures

IRS selects plans for examination using a computer program that seeks to identify plans with characteristics that indicate a high potential for ERISA violations. IRS developed this profile from almost 18,000 detailed examinations conducted during a taxpayer compliance measurement program (TCMP) survey of plans' 1978 returns.

The criteria IRS uses to select plans for examination may now be too old to provide an effective means of targeting. IRS expected to find violations in about 66 percent of all examinations selected using this profile. However, in each year since 1985, IRS has found ERISA violations in less than 32 percent of its examinations, and in 1989 only 21 percent of the plans examined had ERISA violations. IRS field staff attribute the low violation rate to the selection system's use of old criteria to identify plans for examination. The selection criteria appear outdated because of the numerous changes in ERISA's provisions and plan characteristics since the TCMP survey.

IRS plans to implement an alternative selection system this year that it hopes will enable it to more quickly and accurately target plans with a high potential for ERISA violations. Although we have not reviewed this plan in detail, it may be preferable to conducting another TCMP survey, because it would likely cost less and produce results sooner. Nevertheless, we believe IRS's selection system should include criteria that target plans that pose a potential risk to the government's pension insurance program because of underfunding.

Ensuring Examination Quality

Historically, IRS's national and regional offices reviewed district office operations, in part to ensure that enforcement programs were effective and examinations met IRS's quality standards. However, IRS suspended this program in 1985. At two of the three district offices we visited, we found that from 1987 through 1989, neither the national nor the regional office had reviewed the quality of any examinations to ensure that they were sufficiently thorough to identify ERISA violations. At the other office, only 29 examinations had been reviewed.

IRS recently initiated a quality assurance program that will review each district office's employee plan operations every 2 years. The program includes a review of the quality of between 50 and 75 examinations. If properly implemented, this program could help ensure that examinations are sufficiently thorough to identify ERISA violations.

IRS Needs to Assess the Impact of Changes in How It Approves Plan Designs

IRS expects to receive many requests from plans to approve plan design changes made to comply with the Tax Reform Act of 1986. To meet this demand and continue to devote most of its ERISA enforcement resources to examinations, IRS made several changes to reduce the time spent reviewing plan designs. First, plans were encouraged to participate in several "volume submitter" programs that enable IRS to approve requests of a large number of plans with standardized provisions without a detailed review of each. Second, for plans that meet certain criteria, IRS intends to approve plan designs without reviewing the plan language to ensure that it complies with ERISA. IRS expects that it will approve up to 75 percent of all such requests without submitting them to an agent for a detailed review and that the great majority of these will be plans with standardized provisions.

IRS's expectations for high participation in the volume submitter program may not be realized. As of April 1990, only 61 out of about 7,000 practitioners who submit large numbers of requests had signed up for the program at the three district offices we visited. If high participation is not achieved, many design changes for non standard plans will have to be approved without a detailed review to meet examination goals and process the requests within the 270-day period specified by ERISA. IRS officials acknowledge that, in some cases, this could result in plans receiving approval for changes in plan design that do not comply with ERISA.

IRS views the approval of plan designs as an important element of its enforcement program. Because of the significant changes IRS has made in the way it approves plan designs, we believe IRS should develop a plan for evaluating the impact of these changes.

LABOR'S ERISA ENFORCEMENT PROGRAM

Within the Department of Labor, the Pension and Welfare Benefits Administration (PWBA) is responsible for enforcing ERISA. Labor focuses its enforcement efforts on conducting investigations to ensure that plans comply with ERISA's fiduciary provisions and are operated in the best interest of their participants. Labor is also responsible for enforcing ERISA's reporting and disclosure provisions.

Early this year, we initiated an assessment of Labor's ERISA enforcement program, focusing on its efforts to correct weaknesses we had previously identified. Our preliminary observation is that Labor has taken actions in recent years to address many of these weaknesses. However, some problems remain that diminish the program's effectiveness.

Enforcement Strategy

In an October 1985 report, we concluded that Labor did not have a comprehensive, consistent, long-term strategy for enforcing ERISA.[2] In response to our report, Labor adopted a new enforcement strategy in December 1986. The strategy allocated 50 percent of PWBA's investigative resources to investigations of significant issue cases. These cases involve organizations that Labor characterized as having high potential for fiduciary abuse. These include (1) financial institutions, such as banks and trust companies, that serve as pension plan trustees, and (2) firms that provide services to welfare plans. The remaining investigative time was to be spent on individual plans.

The results of Labor's ERISA enforcement strategy have been disappointing. Labor's assessment of the strategy indicates that significant issue investigations find fewer violations and take twice as long to complete as investigations of individual plans.

Several factors appear to have contributed to these results. First, Labor has lacked adequate data to effectively target financial institutions and service providers with a high potential for ERISA violations. Second, investigators have not been provided standardized audit guides for investigating financial institutions and service providers. Labor is working to improve its targeting procedures and complete the audit guides.

ERISA Data Base and Targeting of Plans for Investigation

We and others have reported that Labor's ERISA enforcement has been hindered by incomplete, inaccurate, and untimely plan data. Labor and IRS have made substantial progress on these problems, including increasing the amount of information captured from plan annual returns, using extensive edit checks and follow-up contact with plans to improve data completeness and accuracy, and processing return information within 60 days after the return is filed.

PWBA has developed a computerized system to use the improved data base to target plans, financial institutions, and service providers for investigation. Despite this progress, we are concerned that the system may miss plans with significant weaknesses. Certain data in the annual reports reflecting the funded status of defined benefit plans are not included in the system data base for 1988 plan returns, the first year to be included in the improved data base. As a result, Labor can not identify underfunded defined benefit plans for investigation. This information is critical to ensuring that these plans have not committed ERISA violations that may place plan assets and participants' benefits at risk, and that they do not end up becoming liabilities to PBGC and the taxpayers.

Small Staff Size Relative to Plan Universe

Labor has an ERISA enforcement staff of about 200, or about 1 for every 4,500 pension plans. At this staffing level, Labor investigates less than 1 percent of the plan universe each year. Despite the growth in the number of pension and welfare plans since 1984, and the assets they hold, PWBA's field investigative staff remains under 200. Labor's fiscal year 1991 budget requests 133 additional staff members for ERISA enforcement. Although this increase, if approved, is a step in the right direction, it is unclear whether the additional staff and improvements in targeting will be enough to ensure that Labor can provide an effective deterrent to ERISA violations. The small amount of federal resources available to enforce ERISA heightens the importance of annual IPA plan audits.

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[2] Strong Leadership Needed to Improve Management at the Department of Labor (GAO/HRD-86-12, Oct. 21, 1985).

VIEWS ON LABOR'S PROPOSALS ON PLAN AUDITS

ERISA requires administrators of employee benefit plans with 100 or more participants to engage, on behalf of plan participants, an IPA to conduct an annual audit of the plan's financial statements and certain required schedules contained in the annual report.

Labor's Inspector General has expressed concern that IPA audits are not as effective as they could be in ensuring the financial soundness of employee benefit plans because (1) substantial plan assets can be excluded from audit coverage, (2) auditors are not required to test for compliance with ERISA, and (3) violations, if found, are not reported to Labor for enforcement action.

In response to the Inspector General's recommendations, Labor recently proposed two legislative changes in ERISA's audit requirements--to eliminate limited scope audits and to require auditors to obtain peer reviews. Labor is also working with the American Institute of Certified Public Accountants (AICPA) to develop procedures on compliance testing and direct reporting of violations to regulators.

Labor's proposals for strengthening audit requirements, as well as requiring plan management to report on internal controls and compliance with laws and regulations, should improve ERISA oversight and enhance the security of participants' benefits. Additional recommendations for improving ERISA oversight may result from our current review of IPA audits of employee benefit plans.

The Need for Full-Scope Audits

ERISA allows plan administrators to exclude assets that are held by regulated financial institutions, such as banks and insurance companies, from the scope of IPA audits. Instead of examining the financial institution's records, the auditor can, by regulation, accept the institution's certification that the statement of assets received by the plan is accurate. As a result, significant amounts of plan assets are not audited. The Inspector General recently found that nearly half the IPA audits it reviewed had such a scope limitation.

Labor has proposed amending ERISA to repeal the limited scope exemption. Although we have not evaluated the specific details of the proposal, we agree that full-scope audits should be required for employee benefit plans.

Internal Control and Compliance

Labor is working with the AICPA in its revision of the industry audit guide applicable to ERISA audits to clarify and strengthen audit requirements concerning internal controls and compliance with ERISA. We believe strengthening plan management's reporting requirements should also be considered.

Plan administrators should be responsible for establishing sound internal controls and complying with ERISA and regulations. We have long advocated management reporting requirements that assess the effectiveness of internal controls and compliance with laws and regulations. Accordingly, we believe that as a part of the annual independent audit of financial statements, the auditor should be required to report on plan management's assertions regarding the effectiveness of its internal control structure and compliance with laws and regulations, in addition to issuing an opinion on the financial statements.

We believe that requiring the auditor to review and publicly report on plan management's report on internal controls, including controls for compliance with laws and regulations, significantly enhances the reliability and credibility of the report and results in improved internal controls.

Our opinion on the need for management reporting and auditor review is driven by three fundamental beliefs.

First, the federal government, as insurer of defined benefit pension plans, faces a significant potential liability should plans with large unfunded liabilities terminate. Requiring auditors to review plan management reports would help protect the federal government's interests and ensure that plans maintain strong internal controls, adhere to laws and regulations, and properly report their financial condition.

Second, plan administrators have a fiduciary responsibility to operate plans in the best interests of plan participants. Requiring plan administrators to report to the regulators on their responsibilities for establishing and maintaining an effective internal control structure, including controls for compliance with laws and regulations, and on the effectiveness of their internal controls would help ensure that controls are being maintained.

Third, the accounting profession has a responsibility to protect plan participants, and the government's and the taxpayers' interests, when auditing an employee benefit plan. Therefore, the profession should take a proactive role in assisting plans and the regulators in identifying, preventing, and correcting problems in financial reporting and internal controls. Because regulators have come to increasingly rely on "off-site" monitoring using reported financial information, it is imperative that this information be accurate, comprehensive, and reliable. The accounting profession is in a unique position to provide this assurance.

Direct Reporting

Given the potential liability to the government as an insurer of defined benefit plans, we believe that Labor should be informed, particularly of major fraud or serious fiduciary violations, directly and promptly. The plan administrator should be responsible for reporting violations identified by the auditor to Labor. However, the auditor should report the violations if the plan administrator does not fulfill this responsibility.

Peer Review

Labor has proposed that IPAs obtain a peer review every 3 years to be qualified to conduct ERISA audits. Currently, not all IPAs performing ERISA audits must undergo peer reviews. Peer review is essentially the verification by other accountants that an accountant or firm has a system of quality controls that provides reasonable assurance that audits are conducted within established standards.

The peer review program is the cornerstone of the accounting profession's quality assurance mechanism. Because the federal government is exposed to potentially tremendous losses from its pension insurance program, serious consideration should be given to requiring mandatory peer reviews for all auditors of insured plans.

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Mr. Chairman, this completes my statement. I would be happy to answer any questions at this time.

Chairman PICKLE. OK. Thank you, Mr. Delfico.

Yesterday, the subcommittee heard testimony regarding six cases in the ERISA field. One of those cases was the so-called Lundberg case, where there was a question of embezzlement of some $9 million. It was reported yesterday that no audit had been made of the Lundberg case within 18 months from the time he got control of it with obviously the intent for embezzlement. It was further stated, though, that even if there had been an audit report made, the information that an audit would have produced would not have been much help.

Are you familiar with that set of facts and would you agree, or, more specifically, would the proposed changes that you are recommending regarding auditing standards address this question?

Mr. DELFICO. Mr. Chairman, the proposed changes would touch on a few aspects of that question, and we would encourage the Congress to consider these changes. I am somewhat familiar with the case you have brought up, particularly as it relates to the time between audits. At issue is that the amount of enforcement resources available to do these audits is meager.

As we pointed out and you pointed out in your opening statement, 18 months between audits is too long.

Chairman PICKLE. Well, you say you need more personnel. Let me ask you, does the PWBA have the ability to effectively target those plans that should be audited and will you have enough manpower to produce the information needed?

Mr. DELFICO. I think in both respects we have a question about the computerized targeting system that they have developed. Although we are awaiting the results of their newest targeting approach, the information in their data base for 1988 does not identify plans that are underfunded. We feel very strongly that the Department of Labor should be considering along with other factors the underfunded status of plans before they target. Underfunded plans are the ones that would pose a serious threat to PBGC.

Chairman PICKLE. Well, according to the Department of Labor, they feel that that agency has made significant improvements in the form 5500 and that the information there is very helpful.

Have you, the GAO, had the opportunity to evaluate the effectiveness of the so-called revised form 5500?

Mr. DELFICO. We have evaluated the revised 5500 and would agree that there has been a significant improvement in the quality of that data base. They have computerized more information off the 5500, improved the accuracy of the information, and they have done a lot more to cleaning up the data once they get it.

It is also being turned around a lot more timely than it has in the past, so it is becoming a very effective enforcement tool.

Chairman PICKLE. Well, is the information that is on the 5500 specifically useful to the PWBA's enforcement efforts?

Mr. DELFICO. By and large, I think it is.

Chairman PICKLE. Well, does the PWBA have sufficient staffing and resources to effectively carry out its responsibilities under ERISA as a whole?

Mr. DELFICO. We have said since the mid-1980's and back into the early 1980's that their resources are quite low, and we don't think they can carry out their responsibilities effectively with the level of resources that they have had in the past.

Chairman PICKLE. The DOL inspector general has recommended that ERISA violations be subject to stiffer criminal prosecution. Will you comment on that.

Mr. DELFICO. We understand that the IG at DOL and the Secretary of Labor are now studying that particular issue. We haven't had a chance to see their conclusions yet, so we are not in a position to comment on that right now, Mr. Chairman.

Chairman PICKLE. Well, have you reached no conclusion on that?

Mr. DELFICO. No, we haven't, Mr. Chairman.

Chairman PICKLE. Well, we would ask you, then, to make an evaluation for us and see what you would recommend. This committee is not trying to be trigger happy, but we want to know are we putting sufficient emphasis on the criminal aspect of it. I want to get your opinion on it. Have you made any kind of an evaluation of the IRS's small plan audit program?

Mr. DELFICO. We haven't evaluated the small plan audit program except for noting that it will probably result in some significant revenues.

I think the estimate is between $600 and $800 million. But our concern is that, again, we are talking about small plans that are overfunded. While there may be ERISA violations in those small plans, they are not the plans that pose a risk to PBGC, and to focus on those plans at the expense of not focusing on underfunded plans raises some concerns with us.

Chairman PICKLE. Well, let me ask you a rather broad question now. Does the Internal Revenue Service, in the present operation, effectively target for audit plans which are more likely to be in violation of ERISA?

Mr. DELFICO. Well, I don't think at this time they effectively target. They are working with targeting criteria based on old data. IRS's audits haven't resulted in the violations rates that it had predicted.

Back in the early 1980's when the data were developed they were expecting somewhere around 66 percent. I think they are finding violations in between 20 and 30 percent of the cases now. I don't think they are happy with it, either.

Chairman PICKLE. Well, throughout your testimony you raise questions about the seriousness of the effectiveness both of targeting and carrying out the audit and is the information available, so I would assume that based on what you have just said earlier that you have serious reservations that they are really effectively targeted and making proper audits or proper use of the information, so this must be a problem for us as a committee to look at. Is that correct?

Mr. DELFICO. I would agree, Mr. Chairman, yes, it is correct.

Chairman PICKLE. All right.

Now, Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Delfico, to follow up on that, did I understand you correctly to say that through their targeting that they are finding problems in 20 to 30 percent of their audits?

Mr. Delfico. I think in general the Department of Labor and IRS are finding problems in about 20 to 30 percent of the cases.

Mr. Schulze. Now, are those problems broken down further as to whether they are criminal problems, whether they are inadvertent problems, whether they have problems because of complexity so that we could then target the remedies?

Mr. Delfico. We reported the breakdown of the problems about a year ago, and most of them were civil problems. I don't think they were criminal problems. They do break down the problems in terms of the kind of violations. For example, fiduciary violations are a problem, prohibited transactions I think are one of the highest ERISA violations.

Mr. Schulze. What solution would you recommend? What we are talking about is a matter of identification, how you would eliminate that as a major source of the problem?

Mr. Delfico. We would encourage both IRS and DOL to take a look at their targeting and work with the Pension Benefit Guaranty Corporation to have the three agencies work together to provide input for areas they should target for ERISA violations.

Mr. Schulze. PBGC, IRS, DOL, do they work together or are they working in different directions? Should we think about forming some new entity which would combine these operations? Where should we be in 3 to 5 or 10 years?

Mr. Delfico. We have talked about that problem for years at GAO, and there is no easy answer to it. I think it is worth trying to get the three agencies to work better together. As in any entities that are separated with different goals and missions, and in the case of IRS and the Department of Labor, the missions of the agencies may conflict. I think it is worth a look.

Mr. Schulze. In your statement you discuss ERISA's requirement that administrators of employee benefit plans with 100 or more participants engage an IPA. What percentage of plans have 100 or more participants?

Mr. Delfico. The percentage of plans with 100 or more participants is small. I think the percentage of plans with 100 or more participants is less than 20 percent of all plans.

Mr. Schulze. 20 percent.

Mr. Delfico. Less than 20 percent of all plans but most of the participants.

Mr. Schulze. Thank you.

Thank you, Mr. Chairman.

Chairman Pickle. Mr. Chandler.

Mr. Chandler. Yes, thank you, Mr. Chairman, and Mr. Delfico. I am impressed with your testimony and the work that you have done.

In your testimony you mention that at the IRS much of the focus is on small overfunded plans that pose little risk to participants and to PBGC. Could you comment further on that? What are they up to there and what is going on? Why are we fooling around with plans that are overfunded and in good shape?

Mr. Delfico. Mr. Hansen will address that.

Mr. Hansen. Mr. Chandler, this is a special revenue initiative that IRS put in its budget. They did some analyses that showed some indications that these small plans were making very large contributions for each of the participants. These small plans have five people or fewer participants. IRS was concerned that the manner in which contributions were being made exceeded full funding limits that ERISA places on those plans. What they plan to do over the next fiscal year, is devote almost half of their examination resources to looking at about 18,000 small defined benefit plans where these conditions exist.

As a result of that, they expect to get additional tax revenue of somewhere between $600 and $800 million.

Mr. CHANDLER. Are we talking here about a difference of estimates based on assumptions of interest rates and that kind of thing? Is that basically the issue?

Mr. HANSEN. That is basically involved, Mr. Chandler, yes.

Mr. CHANDLER. Do you think this is an action that is largely revenue driven? Is that your judgment of what you saw?

Mr. DELFICO. Mr. Chandler, it appears that on the surface it is largely revenue driven, although you do find ERISA violations in many of the small plans. So, it is hard to say what is the prime impetus for this.

Mr. CHANDLER. But the $600 million in additional revenue doesn't come from the discovery of ERISA violations?

Mr. HANSEN. Largely it would come from disallowing the deductions that businesses had taken for the contributions to the plan.

Mr. CHANDLER. Mr. Chairman, I believe this is a significant issue, and it is something that I believe ought to trouble this subcommittee. An inordinate amount of resources are being focused on plans that are actually overfunded, at the present moment, at least; pose no risk to PBGC, and, again, may well discourage plan sponsors from continuation of their plan.

Every time you peal a layer of this onion, you find more onion there. I believe the witnesses here have rightly focused attention on this question. I don't have any judgment to render at this point except to say that if there are those who are violating ERISA standards, underfunding plans, creating a potential liability for PBGC, that ought to be of at least equal concern as those who overfund their plans.

I would like to have you expand a little more on the independent public accountant's audit. We know that there is the suggestion that those be more important, that they practically place in the hands of an independent accountant an enforcement tool.

Could you expand your thoughts on that and advise the committee where you think we ought to go in that regard.

Mr. DELFICO. Mr. Chandler, with me is David Clark. He is from our Accounting and Financial Management Division and has worked very hard in that area. I would like David to take that.

Mr. CHANDLER. Thank you.

Mr. CLARK. Thank you.

With respect to enforcement, the public accounting firm or the IPA, has no enforcement powers, but the work of the IPA, in the sense that that is reported to DOL, provides an enforcement tool to DOL. It provides a piece of information to DOL. It provides a piece of information to plan participants, and can also provide information back to a plan administrator on how well that plan is being run from a financial perspective or an internal control perspective.

So to that extent it creates more information, more opportunity for DOL to target what we think might be scarce resources in this area to those plans that have a problem.

Mr. **Chandler**. On the chairman's question about 5500 forms, how useful is the information in a 5500 form? Is any of this computerized data? Are we talking about paper data? Is it readily assimilated? Could you describe it?

Mr. **Delfico**. Yes. The form 5500 is a paper tax form that can readily be converted to a computer data base to analyze. We have used it for years in our analysis for this particular committee and the Department of Labor and IRS both use it. So it is now fairly accessible, and it is quite an extensive form.

Mr. **Chandler**. That is a vast improvement, I believe, over past years where you literally had boxes of paper sitting around that were never examined?

Mr. **Delfico**. That is correct.

Mr. **Chandler**. Is the information required on the 5500 form of a nature that with some analysis we can expect Labor to red flag some plans and pursue investigations that would turn up the kinds of cases that we heard about yesterday or reveal those that are truly underfunded, ERISA violation cases and so forth?

Mr. **Delfico**. I don't know if the data base would provide information to detect the kinds of cases you heard yesterday. In some cases they may not report on the 5500 because they may be small plans with below 100 participants. The reporting requirements are different for small plans than they are for large plans. I think you need additional information to target small plans. The 5500 I don't think will do a good job of that.

Mr. **Chandler**. The kind of information that you are talking about, would this in your judgment place a burden on a small plan sponsor? Would this be readily available from——

Mr. **Delfico**. Financial information from the small plans is required every 3 years rather than every year, so that has been considered in asking them to fill out the 5500 form.

Mr. **Chandler**. All right.

Then, finally, I thought Mr. Schulze asked a key question about the relative jurisdiction, PBGC, which is at risk; the IRS, which is trying to make sure that no one games the system as far as taxes; and the Department of Labor which has enforcement responsibility for ERISA.

As I understand your answer, it is something that you found troubling as a question of who is in charge and do they work together. I would like to know more about that problem. Do we need a single agency to handle all the enforcement, to look out for the interests of PBGC as well as the taxpayer? It looks a if in one case you may well have IRS and what you describe in the small plan area working at cross purposes with PBGC.

Could you comment on that.

Mr. **Delfico**. We are not prepared to comment on whether you need a single agency to do that right now. I am prepared to comment that I think in theory, a single agency would probably lead to better communications, better use of data, better use of personnel and a single mission objective for the audit and the oversight of ERISA.

As I pointed out today, it is questionable whether the mission objectives of the agencies involved are in sync, although they are carrying out their ERISA responsibilities as they see them.

Mr. CHANDLER. Mr. Chairman, thank you very much.

Chairman PICKLE. I thank you, Mr. Chandler.

Now, Mr. Delfico, you told Mr. Schulze a few minutes ago that some 20 to 30 percent of the cases had problems, serious problems and ought to be looked at. I think the figure is around 21 or 22 percent as a fact.

Now, will you provide to this committee a list of those problem cases that you have made reference to?

Mr. DELFICO. We could provide you with a list of those cases, yes, Mr. Chairman.

Chairman PICKLE. We want that for the record, so will you follow through on that?

Mr. DELFICO. Yes.

[The following was subsequently received:]

As agreed with your staff, we have updated the information provided you in our January 1989 report on the number and types of ERISA violations identified by IRS and Labor. We did not review individual cases, and therefore can not identify specific plans that violated ERISA. This information is, however, available from IRS and Labor records.

The IRS information is as follows.

Number and Types of Plan Violations Identified by Internal Revenue Service (Fiscal Years 1988-89)

	Fiscal year	
Type of violation	**1988**	**1989**
Minimum funding	1,305	2,309
Prohibited transactions	3,158	5,272
Coverage and participation	2,864	4,302
Vesting or benefit accruals	1,036	1,400
Discrimination of contributions or benefits	628	950
Deductibility of contributions	1,110	1,686
Actuarial issues	245	591
Trust activities	2,497	5,264
Failure to file required statements or returns	137	156
Distribution of benefits	532	1,567
Other[a]	459	1,008
Total[b]	13,971	24,505

[a] Includes violations involving benefit and contribution limits, taxes due on reversion, and the revocation of a plan's tax-qualified status for exclusive benefit rule violations.

[b] The total number of violations exceeds the total number of plans cited for violations because some plans had more than one violation.

The Department of Labor is not yet available. We will provide it to the Subcommittee as soon as it is available.

Chairman Pickle. You also said most of the cases you audit or look at are civil cases, and I am sure that is basically correct. That is, that you just almost automatically treat an audit with respect to a civil penality approach.

Isn't it true that many of these cases might have criminal violations or possible violations for willfulness or fraud or abuse, and they are deemphasized? Shouldn't we put more emphasis on the criminal aspect, or as these cases are audited, should we make that part of the consideration also?

Mr. Delfico. I think it should be part of the consideration when an audit is made, yes. I think there should be some emphasis placed on that.

Chairman Pickle. All right.

Now, lastly, I want to ask you your opinion about the overall approach, you or any of your GAO people, you have made an analysis of the program. In your judgment is there sufficient coordination and cooperation between the IRS, Department of Labor, Justice, the PBGC and PWBA with respect to these different audits? Is there full coordination between all of these agencies to be certain that with respect to both civil and criminal approaches that the full remedies are being use? Can you comment on that about the cooperation of all the agencies?

Mr. Delfico. They do cooperate, but it is our view that there could be better cooperation amongst the agencies. We have some questions about how they get along and share information, particularly in the areas you have pointed out.

Chairman Pickle. Well, now be more specific for me. Can you?

Mr. Delfico. Well, we are just starting our work at PBGC, for example, and we are not sure how much information the Pension Benefit Guaranty Corporation shares with IRS and vice versa, and we are not sure about the cooperation between PBGC and Labor.

We are going to be investigating that in the next 6 months or so. We will be able to fully answer your question, Mr. Chairman.

Chairman Pickle. Well, what kind of cooperation do we have between the Labor's PWBA and the inspector general?

Mr. Delfico. Mr. Hansen has been working on that. I think John could answer that question for you.

Chairman Pickle. Mr. Hansen, will you tread for us into those waters?

Mr. Hansen. Yes, I will, Mr. Chairman.

First, let me say that one of the things we have looked at with regard to cooperation between IRS and Labor is referrals that they make between one another.

Labor may do an investigation and find what they consider a funding problem, which is IRS's responsibility, and make a referral to the local IRS office of a case, and it happens the other way as well, IRS makes referrals back to Labor of possible fiduciary violations that they uncover as part of an examination.

One of the things that we found was that the local offices do meet regularly and exchange these cases on a regular basis. Where we have a concern is that there doesn't appear to be right now a whole lot of activity on either side's part on the cases the other agency refers.

We are not sure we understand why yet, but I think that speaks to the kind of cooperation situation that you were interested in.

Chairman Pickle. Well, we will ask some of these other departments similar questions because we are concerned about the lack of full cooperation or the slowness in which information is exchanged and the cumbersome way in which we have to approach the problem with some 900,000 plans.

Mr. Chandler. Mr. Chairman, would you yield to me for one more question, if I may?

Chairman Pickle. Mr. Chandler.

Mr. Chandler. As you know, one of the requirements for reporting is a summary annual report which is to be provided to the participants of a plan.

Now, in the case that we heard about yesterday, the Lundberg case, apparently the summary and the annual report was never even provided to the participants any way, obviously in violation of law. So it was of no use to those participants, but for the people who do get a summary annual report, is that information useful? Does it provide something from which a person could make a judgment about the funding of his or her plan, its management and so forth? Is it more costly than it is worth, in your judgment?

Mr. Delfico. Well, our experience has been that plan participants find it difficult to understand what is in the plan documents. A major problem is communicating what is in the plan document to a lay person. At times you need an interpreter to do that. I don't think that the plan documents are not useful. I think they are useful, but they should be cleaned up, put in plain English, to put it bluntly. Most of the plan documents are very difficult to follow.

Mr. Chandler. As a matter of fact, reports I hear is that it is almost more frightening for participants to receive this information than it is enlightening.

Mr. Delfico. That is correct.

Mr. Chandler. You would agree with that judgment?

Mr. Delfico. Yes, I would agree with that.

Chairman Pickle. Well, Mr. Delfico, we appreciate it. We have several panels. We are going to go ahead. We will keep in touch with you. We may have another review of this sometime during the year. We have got to realize, again, with some 900,000 plans, where the assets total over $1.7 trillion, that is the biggest pot of money in the world today, and at the heart of all this is the question, is that large amount of money out there being safeguarded so the workers get their benefits when it comes their time to retire. A lot is at stake in the evaluation of this.

We thank you very much for your testimony.

Mr. Delfico. Thank you, Mr. Chairman.

Chairman Pickle. The next panel will be Robert Brauer and Secretary David Ball.

This panel consists of Robert Brauer, who is the Assistant Commissioner for the Internal Revenue Service. He represents the EPEO groups. Mr. Brauer is an old testifier before our committee. We are glad to have him again.

And, David Ball from the Department of Labor, who is the Assistant Secretary for Pension and Welfare Reform Benefits, and also is well-informed on this subject.

We are glad to have both of you gentlemen with us. We will ask Mr. Brauer to proceed first, if you will. Your entire statement will be made part of the record, as will Mr. Ball's.

STATEMENT OF ROBERT I. BRAUER, ASSISTANT COMMISSIONER, EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS, INTERNAL REVENUE SERVICE, ACCOMPANIED BY WILLIAM B. POSNER, ASSISTANT DIRECTOR, EMPLOYEE PLANS TECHNICAL AND ACTUARIAL DIVISION

Mr. **Brauer**. Thank you, Mr. Chairman.

I am delighted to be here this morning to discuss the role of the Internal Revenue Service in enforcing the provisions of title II of the ERISA Act.

Joining me today is William Posner, Assistant Director of my Employee Plans Technical and Actuarial Division.

The Service has approximately 950 agents nationwide charged with enforcing title II of the ERISA statute. Of this total, approximately 300 agents currently review determination letter requests, and approximately 650 agents conduct examinations of pension plans. Our examination coverage is at a 13 year high, at 3.6 percent, and we expect to maintain it near that level even in the face of an anticipated increase in determination receipts over the next 2 years.

In my remarks today I will answer the questions posed to us in your letter of invitation.

Your first question asked for a description of how the Service selects plans for audit.

We use several methods. We obtain approximately 40 percent of our cases using information developed through the taxpayer compliance measurement program (TCMP). As you know, Mr. Chairman, TCMP is both an enforcement program and a scientific compliance measurement system which analyzes and evaluates compliance characteristics. We also employ a system of condition codes that identifies the characteristics of returns that we feel may warrant attention. Condition codes account for another 40 percent of our selections. Examples of these conditions include indications of plan termination, party-in-interest transactions, reversion of plan assets to the employer, and very low investment earnings. Often these codes are used to select returns for examination programs identified as special emphasis areas. An example of current special emphasis programs is the defined benefit plan actuarial program I will describe shortly. There is another category of cases, accounting for an additional 10 percent of the returns selected for examination, that results in the automatic review of the return by an agent. These conditions include, for example, funding deficiencies identified from the information submitted on the return. The remaining 10 percent of the returns are obtained from referrals from the Department of Labor and local initiatives, such as complaints we receive from plan participants and referrals from our income tax examination divisions.

Chairman **Pickle**. Mr. Brauer, I don't want to interrupt you, but haven't I read or received information that you are changing your taxpayer compliance measurement approach? You are either modifying it or you are going to take a different approach?

Mr. **Brauer**. That is right, Mr. Chairman.

In the pension area, my own view is the taxpayer compliance measurement program, which is based on very old data, is not a terribly effective way——

Chairman **Pickle**. Will you make reference to that later in your estimony?

Mr. **Brauer**. Yes, I will.

Chairman **Pickle**. All right.

Go right ahead.

Mr. **Brauer**. Your second question asks for our opinion on the imeliness and utility of the information obtained from plan sponsors through the form 5500.

We feel that the current forms provide sufficient and timely information to conduct our examination program. Until recently, the Service and the Department of Labor did not have computer access o all the data filed by the plan sponsor. Only 40 to 50 percent of he data items were transcribed by our service center personnel. Therefore, the measure of the data's utility was often less a result f the content of the form itself, but more an issue of how many ntries on the form were transcribed. However, beginning with the plan year 1988 filings, virtually every line item on the form is now ranscribed and available on our computer system and those of the Labor Department. With this improvement and with related efforts o ensure the proper completion of the forms by the filers, I feel we have the ability to utilize our examination resources more efficiently. We also have a major effort underway to develop a new system hat will assist us in identifying potential areas of abuse, quickly stablish the extent of that abuse and put in place specific examination programs to correct the cause. I expect this system to be in place this year. In meetings with representatives of the General Accounting Office, they indicated that our plans in this area were teps in the right direction.

You next asked for the number and disposition of examinations onducted by the IRS and the number and disposition of cases referred by the IRS to other agencies.

Our examination program is a vital part of the overall Government effort to ensure the security of assets in the private pension ystem. As we testified before this subcommittee in 1988, my office made a strategic commitment to devote a majority of our compliance resources to conducting examinations of employee benefit plans to maintaining the timely delivery of determination letters equested by plan sponsors amending our new law. With an examination coverage rate that had fallen to less than 1 percent in 1987, here as significant room for improvement. Our examination program has accelerated dramatically since 1987, when we examined ,669 returns. In 1988, we more than doubled that number to 0,543 and in 1989 we examined 36,681 returns, more than four imes the number of 2 years earlier. Our examination coverage ate now stands at 3.6 percent of the return universe. This compares quite favorably with the coverage rate of approximately 1 ercent for individual returns and 2 percent for corporate returns. We intend to maintain our coverage near that level and to continue to improve our selection criteria for plans with indices of noncompliance.

Chairman PICKLE. I will interrupt you again, Mr. Brauer, to say that we are glad to see that the audit percentage is increasing. I don't understand why we got down to 0.59, but that was unacceptable. You are up to 3.6. You are ahead of our groups, so we make that observation.

Thank you.

Mr. BRAUER. I appreciate that, Mr. Chairman.

In 1989, the Internal Revenue Service made over 1,600 referrals to area offices of the pension welfare administration of the Department of Labor.

During fiscal year 1989, our pension actuarial branch received 189 rulings requesting a waiver of the minimum funding standards. We referred 10 of these requests—each in excess of $1 million—to the Pension Benefit Guaranty Corporation. This referral process is pursuant to section 412(f)(3)(b) of the code as added by SEPPA. Written comments from PBGC are received and considered in our deliberations in each of these cases and the PBGC is invited to any taxpayer conferences that take place. We also share the information with PBGC on waiver requests of less than the threshold $1 million where we believe they would have an interest.

In fact, in that regard I might add, Mr. Chairman, as a practical matter, we send PBGC every waiver request of $50,000 or more so they can see whether they have an interest in it.

Chairman PICKLE. Does PBGC come to any of your so-called reviews or meetings?

Mr. BRAUER. On the small cases, if they wish, they are invited to every case they wish to participate in.

Chairman PICKLE. I know they are invited. Do they actually come and participate?

Mr. BRAUER. They come to all the big cases and they come to some of the smaller ones.

Chairman PICKLE. All right.

Mr. BRAUER. You asked us to describe the effect of recent enforcement initiatives that are identified in the President's budget for fiscal year 1991 on potential Federal pension liabilities.

We have en examination program specifically mentioned in the budget. It is our defined benefit actuarial examination initiative. The program has as its basis a longstanding effort to address what the Service considers to be question able tax practices in the case of a small number of defined benefit plans. Specifically, the Service is questioning the funding of defined benefit plans where the annual pension contribution claimed per participant indicates that the actuaries may have exceeded the contribution limits for any of several reasons including: Using an inappropriate funding method; exceeding the maximum benefit limitation under section 415; and employing unreasonably low interest rates or retirement ages not supported by the facts and circumstances of the plan.

In a substantial number of cases, all or most of the contribution is disallowed due to the legal issues such as funding method or section 415, without ever reaching the interest rate and retirement age assumption issues.

Contributions to these plans are tax deductible. By utilizing one
r more of the practices I have mentioned, employers can take ex-
essive deductions. Such deductions may come to hundreds of thou-
ands of dollars annually per plan.

Chairman **Pickle**. Mr. Brauer, when you said by utilizing one of
hese practices, employers can take, what did you say, an excessive
leduction? Have you identified or will you identify for us some of
he ways in which they can do that?

Mr. **Brauer**. Yes.

Well, they do it through the methods of these three areas essen-
ially that I have indicated, but I can be more specific later if you
vould like.

Chairman **Pickle**. Please do that.

Mr. **Brauer**. The program is designed so that only 18,000 returns
re examined out of a universe of over one-half million. The pri-
nary selection criterion used is amount of annual contribution per
articipant. Our research shows that over 98 percent of plans re-
orting over $100,000 in contributions per participant—that seg-
nent of plans that is more likely to employ the questionable prac-
ices noted above—are in the 1 to 5 participant plan sector. Within
he universe of the hundreds of thousands of defined benefit plans
hat are not under our examination program, the average retire-
nent age and interest rate assumptions used by actuaries are sig-
ificantly higher than the average age and interest rate of 57 and
.2 percent, for plans in which the Service made an adjustment as
result of an examination.

The average contribution per participant to a defined benefit
lan is less than $5,000. In the first 500 cases which our agents
ave completed examining, the average annual pension deduction
laimed was $215,000, with 11 individuals claiming over $600,000 in
nnual pension deductions and 48 others claiming over $300,000. In
hese cases, the average adjustment recommended by the agent
vas $194,000. Our experience thus far shows that over two-thirds of
ur cases involve plans of doctors and lawyers; the rest consist of
ther highly paid individuals.

With your permission, Mr. Chairman, I will include a lengthier
tatement regarding this program in the record. Let me just add
hat I have instructed our agents to judge each case on its own
nerits, based on its own facts and circumstances. We believe the
vidence to date confirms our view that this is an area where cer-
ain individuals, working with their pension consultants and actu-
ries, have taken significantly larger pension deductions than the
aw allows.

You next asked us to comment on the adequacy of IRS staffing
nd resources to effectively carry out our responsibilities under
RISA.

In fiscal year 1990, we estimate that our field offices will review
pproximately 100,000 employee plan amendments, plan termina-
ions, and new plan applications. In fiscal year 1991, that number
vill more than double. The number of employee benefit plan deter-
nination applications varies from year to year as a function of the
ffective dates of new or revised laws, of which there have been 15
ince the enactment of ERISA. For example, the projected increase
n applications in fiscal year 1991 will occur as plans amend to con-

form with the provisions of the Tax Reform Act of 1986. We will, however, be able to issue determination letters in a timely manner in fiscal year 1991 through expanded use of various volume submitter programs which will enable us to quickly process applications from adopters of these plans. These plans can be quickly reviewed because, once the lead plan has been approved, there are only a few remaining issues for our agents to consider, and these few issues are submitted on a short form by the plan adopter. Accordingly, we do not foresee any meaningful reduction in our current examination program.

Finally, Mr. Chairman, you asked as to the likely effect on the employee benefit system if the IRS were to place increased reliance on criminal sanctions as opposed to civil remedies.

Our examination program results do not reflect widespread violations of those criminal tax provisions which IRS is charged with enforcing. Our agents do discover instances of self-dealing involving plan assets which can lead to criminal prosecution. One recent referral of a matter involving misappropriation of funds from 2 pension plans over a number of years did result in a criminal indictment. Our agents also find a relatively small number of instances of backdating of plan documents. As to those few instances which may involve violations of criminal provisions, they are largely found in the small plan sector and not in the large defined benefit plan sector. Furthermore, very few such cases are prosecuted criminally because of the difficulties inherent in the criminal litigation process. Consequently, I do not believe there would be a beneficial effect if IRS were to place more reliance on criminal sanctions. Civil sanctions exist, and they are by and large adequate to enable us to properly enforce the law.

I might add at this point, Mr. Chairman, that, of course, other matters that may result in criminal enforcement action involving title I of ERISA are routinely referred to the Labor Department since DOL is charged with enforcing the fiduciary provisions of ERISA.

This concludes my testimony, Mr. Chairman. I will be happy to answer any questions you may have.

[Addendum to Mr. Brauer's statement follows:]

Addendum to Testimony of Robert I. Brauer
Assistant Commissioner (Employee Plans and Exempt Organizations)
Internal Revenue Service
Before the Subcommittee on Oversight
Committee on Ways and Means

June 13, 1990

DEFINED BENEFIT PLAN EXAMINATION PROGRAM

The program has as its basis a longstanding effort to address what the Service considers to be questionable tax practices in the case of a small number of defined benefit plans. Specifically, the Service is questioning the funding of defined benefit plans where the annual pension contribution claimed per participant indicates that the actuaries may have exceeded the contribution limits for any of several reasons including:

1. using an inappropriate funding method,
2. exceeding the maximum benefit limitation under section 415,
3. employing an unreasonably low interest rate not supported by the facts and circumstances of the plan. (In the plans adjusted among the first 500 cases closed, the average interest rate used was 5.2%), or
4. employing an unreasonably low retirement age not supported by the facts and circumstances of the plan. (In the plans adjusted among the first 500 cases closed, the average retirement age used was 57.)

In a substantial number of our cases, all or most of the contribution is disallowed due to the "legal issues" listed above (e.g., funding method or section 415) without ever reaching the interest rate and retirement age assumption issues.

Contributions to these plans are tax deductible. By utilizing one or more of the practices cited above, employers can take excessive deductions. Such deductions may come to hundreds of thousands of dollars annually per plan.

LITIGATION HISTORY

In the summer of 1988, the United States District Court for the Central District of Illinois decided in the Service's favor in a case called Mirza v. United States. The Seventh Circuit Court of Appeals affirmed this decision unanimously in August 1989. The court held that an actuary must base his funding assumptions on "experience and reasonable expectations". Among other things, the plan in Mirza utilized a 5% assumption at a time when safe investments were yielding 12% or more. The Court also found that the actuary had improperly applied the chosen funding method. In Mirza, the appellate court disallowed $510,000 in deductions claimed for the one year in question (1980). On May 14, 1990, the United States Supreme Court denied the taxpayer's petition for certiorari.

The Service's position with respect to the reasonableness of actuarial assumptions is that they are determined on the facts and circumstances of the particular case. This was the position that the Service took in Mirza and it continues to be our position.

In addition to the Mirza case, we have had 35 cases in litigation on these issues. Every case that has been completed has been resolved on terms highly favorable to the government. Fifteen Tax Court cases that were on the docket for trial in March in California were recently settled for an average of 90% of the claimed deficiency. Of the 20 court cases now resolved, $3.2 million has been disallowed, an average of $160,000 per case.

PROGRAM SCOPE

The program is designed so that only 18,000 returns are examined out of a universe of over a half million. The primary selection criterion used is amount of annual contribution per participant, not interest rate or normal retirement age. The program was expanded late in 1989. The expansion was based on the convergence of three events: (1) the appeals court decision in Mirza, (2) our developing the ability to identify with some precision the filers who are claiming the largest deductions for contributions to these plans (thereby indicating the possibility that questionable actuarial assumptions may be used), and (3) our developing computer programs which enhance the skills of our agents to conduct audits of these plans. The program has been identified as one of the Service's Management Initiatives and is included as such in the President's 1991 budget.

We want to emphasize that the Service would conduct this program even if it were not identified separately in the budget. As indicated by the significance of the disallowed deductions in the Mirza case and in the cases that have been settled to date, we would be remiss if we did not vigorously pursue these issues.

Our research shows that over 98% of plans reporting over $100,000 in contributions per participant (that segment of plans that is more likely to employ the questionable practices noted above) are in the 1-5 participant plan sector. Within the universe of the hundreds of thousands of defined benefit plans that are not under examination, the average retirement age and interest rate assumptions used by actuaries are significantly higher than the average age and interest rate of 57 and 5.2%, respectively, for plans in which the Service made an adjustment as a result of our examinations. In those few situations in past years where we have found a large plan employing questionable funding method and actuarial assumptions of this sort, we have taken steps to correct the problem - - that is, we disallow deductions where appropriate.

EXAMINATION RESULTS

The average contribution per participant to a defined benefit plan is less than $5,000. In the first 500 cases which our agents have completed examining, the average annual pension deduction claimed was $215,000, with eleven individuals claiming over $600,000 in annual pension deductions and forty-eight others claiming over $300,000. In these cases, the average adjustment recommended by the agent was $194,000. Our experience thus far shows that over two-thirds of our cases involve plans of doctors and lawyers; the rest consists of other highly paid individuals.

INSTRUCTIONS TO FIELD OFFICES

Early instructions to our regional offices (which advise field agents to challenge interest rates below 8% and retirement age assumptions of less than 65) were written as a guidepost to our field agents to help ensure that a consistent approach was being employed in the treatment of a complicated area with a proven need for review, and to provide a mechanism for separating clearly allowable deductions from others. When some suggested that this initial guidance might be applied without consideration of facts and circumstances of individual cases, instructions were issued to clarify this aspect of the program.

FLEXIBILITY

As in any examination, taxpayers and their representatives are free to present the facts and circumstances used in developing their assumptions. Our procedures provide a method for a field agent to consult with a National Office actuary about the adjustment of assumptions in particular cases. Such consultations are frequent. Through mid-May, our National Office actuaries were allowing retirement ages and interest rates of less than 65 and 8%, respectively, in a significant majority of cases referred to them. In addition to the opportunities available to present the facts and circumstances to our agents, taxpayers and their representatives are free to request technical advice from the National Office if they feel their positions have not been fairly or correctly evaluated.

Of the first 500 cases closed, our agents allowed interest rates of less than 8% in 30% of cases and retirement ages of less than 65 in 20% of cases. In addition, 15% of cases originally selected for examination are closed without taxpayer contact based solely on the review of the facts and circumstances available in our return files. Others are closed without change after a review of the material provided by the taxpayer.

Some have suggested to us that, particularly during the early stages of this program, cases may have been processed without proper consideration of facts and circumstances. Therefore, in addition to the normal appeal rights to which taxpayers are entitled, the Assistant Commissioner for Employee Plan matters, Robert Brauer, has offered publicly to personally review any case closed by one of our field offices in which the facts and circumstances of the specific case were not considered.

TAXPAYER CONCERNS

There have been concerns expressed that the Service is not adhering to its own rulings, notices, and regulations in its conduct of this program. We have thoroughly reviewed each of these concerns and have the following comments on those concerns that have received the most attention.

Some practitioners believe that the Service, under section 412, is required to defer to the actuary (and allow claimed deductions for a pension contribution) even though the Service believes that the actuarial assumptions upon which that contribution deduction was based were unreasonable. As with other aspects of a taxpayer's reported tax liability, the general enforcement and administrative responsibilities conferred upon the Service empower it to question the correctness of a deduction taken for pension plan contributions. Moreover, in enacting section 412, we believe Congress made it clear that it expected the Service to examine actuarial issues and make any needed adjustments. In our view, Congress did not purport or intend to delegate control over the determination of the employer's tax liability to the sole discretion of the employer and its actuary. To the extent that claimed deductions rest on actuarial assumptions, the Service has the responsibility to question the reasonableness of those assumptions within the meaning of section 412.

Claims that the Service is applying new rules retroactively and not adhering to the audit guidelines put into the Internal Revenue Manual in 1984 are not, in our view, supported by the stated purpose of the guidelines or other Service issuances. In 1985 and 1986, the Service issued fifteen technical advice memorandums that dealt with the same issues covered in this program. These memorandums provided focused analyses of the practices at issue. They encompassed the same interest rate, retirement age, and section 415 issues as are covered in the current program. These documents were widely circulated and discussed by Service officials at practitioner meetings.

On the other hand, audit guidelines such as those issued in 1984 serve the purpose of providing our agents general rules for identifying and addressing certain violations and for assisting in the development of audit issues where no specific area of concern has previously been identified. They do not preclude a more focused and complete examination of issues. Guidelines are simply management tools designed to assist field personnel in allocating and utilizing resources. The Service would be remiss if it allowed nonbinding guidelines to preclude the development of examination efforts directed at areas which we consider potentially abusive. As stated in the guidelines themselves:

> "Because of the diversity of conditions encountered during examinations, these guidelines are not devised to be all inclusive or restrictive."
>
> "These guidelines are not intended to be all inclusive; consequently, the techniques identified in this handbook may be modified based on the actual examination issues encountered."
>
> "It is expected that the guidelines and worksheets will help the examining specialist decide on what areas to concentrate and when to utilize the various worksheets with respect to particular plans. However, the (guidelines), Worksheets and explanations, do not cover every problem that could arise under the minimum funding standard or deductible limits, and the specialist is in no way limited to raising questions relating to only those problems identified." (underlining added.)

Chairman PICKLE. I thank you.

And we will have some questions, but now we will ask the Secretary Ball if he will proceed with his testimony.

We are pleased to have you, Mr. Secretary.

STATEMENT OF HON. DAVID GEORGE BALL, ASSISTANT SECRETARY FOR PENSION AND WELFARE BENEFITS, U.S. DEPARTMENT OF LABOR, ACCOMPANIED BY ALAN LEBOWITZ, DEPUTY ASSISTANT SECRETARY FOR PROGRAM OPERATIONS

Mr. BALL. Mr. Chairman, I am very pleased to appear before you today and testify with respect to the Employee Retirement Income Security Act of 1974. Accompanying me today is Alan Lebowitz, Deputy Assistant Secretary for Program Operations. It's a particular honor, Mr. Chairman, because of the leadership that this committee has demonstrated, with you as chairman, in securing employee retirement income, and it's a very happy occasion for me to testify before your committee today.

Before I discuss PWBA enforcement efforts, I would like to emphasize that Secretary Dole and I are committed to strong enforcement of ERISA. This commitment is reflected in the President's request for significant new budget and staff resources for ERISA enforcement, as well as the Secretary's legislative proposals to enhance ERISA enforcement. I am confident that these initiatives, coupled with the steps already taken by PWBA to improve our enforcement efforts, will continue to improve the quality of ERISA enforcement.

PWBA fulfills its enforcement role under ERISA in two principal ways. First, PWBA maintains a public information and assistance program. In 1989, the PWBA National Office handled 67,000 inquiries and recovered $8.2 million for participants and beneficiaries. An additional 73,000 inquiries were handled by our 15 field offices.

Second, PWBA Office of Enforcement conducts enforcement activities through its national office and 15 field offices. The national office's enforcement program provides policy direction and technical and management support to the field offices.

Presently, there are 303 authorized staff personnel in the Office of Enforcement. Of this total, 266 are field office employees, and 234 of them are investigators, auditors or supervisory investigators.

In addition to the Office of Enforcement, the Office of the Chief Accountant was established within PWBA in 1988 to work with the accounting profession to improve employee benefit plan accounting, audit procedures and practices.

To further enhance our own independent enforcement efforts, PWBA coordinates enforcement activities with a number of other governmental agencies.

As you know, we have a formal memorandum of understanding with the Internal Revenue Service to ensure that the enforcement resources of our respective agencies are used in the most effective way of conducting audits and investigations of employee benefit plans.

This memorandum, which establishes procedures for all applicable investigations conducted by PWBA and the IRS, calls for the sharing of the identity of employee benefit plans before the opening of an investigation to prevent duplication and for the sharing of enforcement related information from our investigations.

The procedures also include a requirement for quarterly meetings by our respective field offices to coordinate enforcement efforts.

In addition, our national enforcement staff coordinate, as appropriate, on policy-related issues on both enforcement and regulatory matters.

The details of these coordination efforts are described in my written testimony. Such efforts include the use of a system for tracking referrals between the agencies.

In 1989, for example, 225 cases were referred from PWBA to the IRS. Our coordination efforts are not limited to working with the IRS, however. PWBA and the office of the Inspector General/Office of Labor Racketeering have been operating under a memorandum of understanding, under which information is exchanged with respect to organized crime activity in the employee benefit plan field.

PWBA also has a memorandum of understanding with the Federal financial regulator agencies, including the Federal Reserve Board, the Controller of the Currency, the FDIC, the Federal Home Loan Bank Board, and the National Credit Union Administration, by which these agencies refer to the Department suspected ERISA violations arising out of their audits.

PWBA also receives enforcement-related information from the Securities and Exchange Commission. A memorandum of understanding entered into between the Secretary of Labor and the Department of Justice provides guidelines for the investigation of criminal matters related to ERISA.

PWBA field officers routinely confer with the local U.S. attorney's office about specific criminal cases.

Finally, PWBA meets and coordinates closely with the Pension Benefit Guaranty Corporation on matters concerning pension issues on a regular basis.

Coordination with State and local agencies is the responsibility of each PWBA field office. PWBA field offices have agreements with the various State banking and insurance commissioners that provide for the sharing of information obtained under their respective statutory authorities.

We are proud of the results we have achieved. In 1989, PWBA conducted a total of 1,581 investigations; 508 were concluded through voluntary compliance, and 43 resulted in the initiation of civil action in Federal district court.

The PWBA also closed 28 criminal investigations that resulted in obtaining 11 indictments. Over the last 5 years, we have closed 8,268 cases that resulted in the recovery of almost one-half of a billion dollars for pension and welfare benefit plans.

We believe that in future years, our enhanced targeting efforts will generate an additional stream of targeted investigations and generate even better results.

While we have seen no evidence of widespread and systematic fraud and abuse of benefit plans, this is not to say that there are no problems.

There are people, unfortunately, who breech their fiduciary duties and some who abuse, embezzle from and commit fraud against plans. For this reason, we must always be vigilant in the enforcement of ERISA. As wrongdoers find new and more sophisticated ways to commit fraud and abuse, we have to find new and more effective ways to protect employee benefit plans.

Secretary Dole and I are committed to protecting the integrity of the private employee benefit system. Having given you a general overview of PWBA's ERISA enforcement program, I would like to turn to action taken by the Department of Labor to improve its enforcement program.

In order to establish policy direction and focus our enforcement efforts, in December, 1986, PWBA issued an enforcement strategy implementation plan which establishes and describes the Department's enforcement strategy and objectives with respect to ERISA.

Our enforcement strategy focuses primarily on large plans; that is, those with over 100 participants.

While large pension plans constitute only about 6 percent of all plans, they represent nearly 90 percent of all participants and approximately 84 percent of all plan assets.

We do not slight small plans; however, in order to leverage our resources, our targeting of small plans is accomplished indirectly by devoting 50 percent of our resources to significant issue cases, those involving service providers to employee benefit plans, and financial institutions that act as fiduciaries to employee benefit plans.

Most small plans are dependent on outside service providers, such as consultants, plan administrators, banks, and investment managers. Through this strategy, an investigation of one service provider or financial institution may impact hundreds, and in some cases, thousands of employee benefit plans.

Under this strategy, we completed 525 significant issues investigations in 1989. Over the last 3 years, we closed 1,013 cases involving 119,000 plans, and 11 million participants.

I would like to take a few moments to describe how our targeted enforcement program has been implemented. The IRS service centers receive the form 5500 annual report from the approximately 900,000 pension and welfare plans that are required to file.

My written statement describes in detail how the data on the form 5500 is subjected to a comprehensive series of automated edit tests to identify deficient filings and generate correspondence to notify filers of deficiencies that are subject to civil penalties if not corrected.

Once the automated edit checks are complete, the IRS forwards tapes containing all of the data to PWBA. The data for all 900,000 plans are then subject to a comprehensive automated review, using specialized targeting criteria.

This new system is a major step forward. Prior to its implementation this year, we were only able to review a small proportion of all plans. Now, for the first time, all annual reports will be screened for accuracy and completeness and will be subject to computer targeting.

In other words, Mr. Chairman, we have all 900,000 plans on our radar screen, and we are zeroing in on fraud and abuse.

Chairman PICKLE. Mr. Secretary, I am glad to see this big change. Why has it been so slow coming to this point? All at once we are going to review all these cases and all the plans are put on the computer.

Mr. BALL. This new information system, Mr. Chairman, has been in development for 4 or 5 years and has only been put in effect with regard to plan year 1988. We are just now getting the results of that plan year.

We have about two-thirds of the plan year 1988 reports available to us on our computer screen. The cases that you considered yesterday in this committee were on a very slow, old-fashioned system which was very difficult to handle.

But with this new system we are going to get benefits. We are already getting the benefits, and I would like to talk to you further about the benefits of this program.

Chairman PICKLE. I appreciate your information.

Mr. BALL. Annual reports that contain information which may be indicative of a violation are flagged, using 95 targeting objectives and are provided to the appropriate field office for followup determination of whether an investigation should be opened.

This sophisticated automation system will allow us to considerably strengthen the deterrent effect of our enforcement program, better manage cases and evaluate the results of targeting an investigative technique.

It will also improve the timeliness of our review. Because financial and actuarial information is not generally available until after the plan year closes, ERISA does not require plan sponsors to file the form 5500 until 270 days after the close of the plan year.

This means that the report includes financial information relating to transactions that actually occurred as much as 20 months previously.

The new automated system ensures, however, that further delays will not result by giving us access to the information contained on form 5500 within 80 to 90 days after a completed form 5500 is filed.

Prior to this system, we have had to wait as long as 2 years to have data available for investigations. PWBA does not rely on computer targeting alone. We target additional cases for investigation in a variety of ways. Many of our cases are based upon leads gathered from individual field office initiated projects.

Other sources of cases are information and complaints provided by participants, referrals from the Internal Revenue Service, financial regulatory agencies, and other leads. Cases are also based upon referrals to field offices from our national office.

In combination, all of these targeting methods constitute a case selection process that is visually illustrated by the chart I have attached as an appendix to my testimony.

Mr. Chairman, I have that chart here, and with your permission, I would like to use it and discuss it with the committee.

Chairman PICKLE. That will be fine.

Mr. BALL. The chart illustrates the four separate and distinct elements of our enforcement strategy. The first outside circle illustrates computer targeting, which I have just discussed. Our new information system reviews every annual report for violations, similar to the way the Internal Revenue Service targets investigations.

We look at all 900,000 plans with 95 targeting objectives, and this covers 70 million people.

The second circle is related to the outer circle. It involves automated correspondence: notification of deficiency in annual reports. This has touched 360,000 plans and 28 million people.

The third circle involves the significant issue cases strategy which I mentioned earlier; 78,000 plans affected by the review of service providers and financial institutions, and 5 million people.

And next, the fourth circle, Mr. Chairman, is manual targeting by our field offices, the review of the annual report by the enforcement staff, and this touches 28,000 plans and 3 million people.

In the center of this chart is the bull's eye; 1,600 targeted investigations touching 106,000 plans, and 6 million people. And we have uncovered ERISA violations in 1 out of every 3 investigations.

The effectiveness of this targeting system would be severely limited if the cases it generates were not investigated by well trained personnel.

All PWBA investigators attend training course, which offer intensive training on such topics as fiduciary responsibility, investigatory techniques and plan accounting.

In order to develop a heightened sensitivity to potential criminal violations, we have been increasing our specialized enforcement training to conducting criminal investigations.

Selected management and staff investigative personnel have attended the white collar criminal training program and the Federal Law Enforcement Training Center in Glynco, Ga. PWBA has also developed its own course on ERISA criminal enforcement.

PWBA has also developed its own course on ERISA criminal enforcement in conjunction with the Department of Justice, the U.S. attorney's office, the FBI, and other criminal enforcement agencies, which will become part of our ongoing training curriculum for investigators.

We currently have open 68 criminal cases compared to 47 criminal cases a year ago. This represents the largest number of open criminal cases in PWBA's history.

With the increased emphasis on training in criminal investigative techniques, we expect our capabilities in this area to be further strengthened. Since ERISA was enacted in 1974, the total number of private employer sponsored employee benefit plans has continued to increase steadily, and the assets held by such plans have increased from about $290 billion in 1974 to $2 trillion today.

During this period, however, there has been no significant increase in PWBA staff. On January 29, it was announced in the President's budget that we will be seeking 100 new positions for civil and criminal enforcement of ERISA, a 33-percent increase in our enforcement staff.

This is the largest increase in the history of ERISA. We anticipate that the increased staff will enable us to conduct as many as 1,000 more investigations each year.

In addition, the administration is seeking 33 additional attorneys for the Department's solicitor to prosecute ERISA cases. While I believe our record is one of accomplishment, there are also ways in which ERISA itself could be improved to enhance our ability to safeguard plan assets and protect the rights and interests of plan participants and beneficiaries.

Secretary Dole has directed a thorough and comprehensive review of all departmental enforcement strategies and activities. This review, which is addressing such issues as the appropriate mix of civil and criminal enforcement, will be completed this summer.

In addition, the Department's office of the inspector general has made a number of recommendations concerning ERISA enforcement. The comprehensive review by Secretary Dole extended beyond the recommendations of the OIG to encompass a broad based review of the state of ERISA enforcement.

As a result, our review addressed not only issues relating to the work done by plan accountants but also included a number of issues related to providing additional incentives for participants and beneficiaries to exercise their private right of action under ERISA and strengthening the disincentives for unlawful behavior.

Our review concluded that in addition to the new enforcement personnel included in the President's budget, a number of statutory changes were warranted. The Department's conclusions are detailed in my written testimony.

In brief, the proposals are: first of all, to strengthen the work done by plan accountants. And in this, we are joined by the office of the inspector general. We are recommending the repeal of the limited scope audit exemption under ERISA, and to require qualified independent public accountants under ERISA undergo a peer review once every 3 years.

We also have recommended incentives for private enforcement, namely, to require the award of attorney's fees and expert witness fees to successful plaintiffs alleging fiduciary violations of ERISA.

We recommend that the Secretary be authorized to award a bounty or a portion of the civil penalties assessed under the new section 502(l) for a fiduciary violation of ERISA to the person who brought information to PWBA regarding the violation. We are also recommending that there be legislation to require judicial review in benefit claims cases where conflicts of interest exist.

We are also recommending certain additional disincentives for unlawful behavior; namely, an increase in the existing excise tax penalties under section 4973 of the code, and civil penalties under section 502(i) of ERISA for prohibited transactions. The increase would be from 5 to 10 percent.

We are recommending that multiple employer welfare arrangements or MEWA's file annual registration statements with the Department, and also certify that copies of such statements have been sent to State insurance commissioners in States where they do business, or intend to do business.

And finally, we have recommended requiring the plan fiduciaries to disclose to participants and beneficiaries, the proxy voting record of stocks held by plans.

At this time, we are not recommending legislation to expand audits to include compliance testing and to require the direct reporting of violations to the Department of Labor. We have instead made a joint proposal with the OIG to the American Institute of Certified Public Accountants for voluntary adoption of needed changes.

A few brief additional comments relating to these proposals are appropriate. We view the criminal and civil sanctions that are available under ERISA as providing a range of enforcement tools.

Neither criminal nor civil sanctions are inherently superior to the other in all situations. For example, criminal sanctions may punish wrongdoers and have a deterrent effect, but they require a significantly higher burden of proof, and they do not by themselves necessarily make plans wholly for losses incurred.

Civil cases are easier to bring. They can join all defendants in one single action, and are more likely to result in making the plan whole. However, they do not have the deterrent effect that a criminal action has against a willful wrongdoer. We seek to pursue the appropriate remedy for a given situation. The legislative proposals I outlined are consistent with this view. They are designed to provide additional methods of improving ERISA enforcement. They should be considered in this context.

For instance, increased excise tax and civil monetary penalties were proposed to provide increased deterrent to wrongdoing, not to raise revenue. Similarly, these proposals are not designed to improve the financial status of the PBGC, as their deficit is not the result of fiduciary violations or fraud and abuse. Rather, it's due to a historical problem with the way the law was drafted.

In conclusion, I am confident that enactment of these statutory changes, coupled with the increase in staff contained in the President's budget and the steps already taken to improve our enforcement efforts will greatly improve the quality of ERISA enforcement.

Secretary Dole and I are committed to strong enforcement of ERISA. The working people of America must be assured that promised benefits will be delivered.

I would be happy to answer any questions at this time.

[The prepared statement follows:]

Statement of David George Ball
Assistant Secretary of Labor for Pension and Welfare Benefits
before the
Committee on Ways and Means
Subcommittee on Oversight
June 13, 1990

I. INTRODUCTION:

Mr. Chairman and Members of the Subcommittee, my name is David George Ball. I am the Assistant Secretary of Labor for Pension and Welfare Benefits. Accompanying me today is Alan Lebowitz, Deputy Assistant Secretary for Program Operations. We are pleased to appear before you today to report on the Department of Labor's enforcement efforts under the Employee Retirement Income Security Act of 1974 (ERISA).

Before I review the Department's enforcement efforts, I would like to emphasize Secretary Dole's personal commitment to a strong, effective enforcement program. This commitment is evidenced by the President's request in the 1991 budget for staff resources for ERISA enforcement. The Department has also recently unveiled a comprehensive legislative proposal to improve plan audits, enhance private rights of action and improve reporting and disclosure relating to multiple employer welfare arrangements and proxy voting. Further, the Department is currently conducting a Department-wide enforcement review to assess the quality of Department enforcement and review the proper balance of criminal versus civil penalties in Department programs. Let me make it clear, tough enforcement is necessary to protect the benefits of the 50 million workers and retirees covered by ERISA pension and welfare plans.

II. OVERVIEW OF ERISA ENFORCEMENT PROGRAM:

ERISA, as you know, was enacted to protect the retirement income and welfare benefits of the nation's private sector work force. Presently, 76 million Americans are covered by more than 900,000 pension plans and 4.5 million welfare plans. ERISA pension plans hold approximately $2.0 trillion in assets, with ERISA welfare plans holding another $25 billion.

Under ERISA, the Secretary of Labor is charged with the responsibility of protecting these assets on behalf of participants and beneficiaries, as well as safeguarding their rights under their employee benefit plans. The Secretary's responsibilities are carried out through the Pension and Welfare Benefits Administration (PWBA). PWBA fulfills this role in two principal ways.

First, PWBA maintains a public information and assistance program. This program deals with a significant number of inquiries from pension and welfare participants seeking assistance in collecting benefits and obtaining information about ERISA. It also responds to plan sponsors and practitioners seeking clarification or information about their responsibilities under the law. In 1989 PWBA's national office handled 67,000 inquiries and recovered $8.2 million for plan participants and beneficiaries. An additional 73,000 inquiries were handled by our fifteen field offices.

Second, PWBA conducts enforcement activities through its National Office and fifteen Field Offices. The National Office's enforcement program provides policy direction and technical and management support to the Field Offices. It consists of three divisions: (1) the Division of Field Operations, which is responsible for oversight of the Field Offices; (2) the Division of Enforcement Support, which provides technical assistance and administrative support to the Field Offices; and (3) the Division of Investigations, which conducts sensitive policy and high visibility investigations.

Presently, there are 303 authorized staff personnel in the Office of Enforcement. Of this total, 266 are Field Office employees, and 234 of them are investigators, auditors or supervisory investigators. There are also 37 employees in the Office of Enforcement in the National Office. ERISA investigations typically require analysis of financial records, including complex paper transactions involving securities, bonds, real estate, and other specialized investment vehicles. Therefore, PWBA recruits investigators and auditors with backgrounds in law, accounting and finance. Investigators come to PWBA from other federal agencies, as well as the private sector. PWBA also recruits qualified graduates directly from professional schools.

In addition to the Office of Enforcement, an Office of the Chief Accountant was established within PWBA in 1988 to work with the accounting profession to improve employee benefit plan accounting, audit procedures and practices. A process has been established under which PWBA refers substandard accounting work to the American Institute of Certified Public Accountants (AICPA) for disciplinary action.

To further enhance our own independent enforcement efforts, PWBA coordinates enforcement activities with a number of other governmental agencies. As you know, we have a coordination agreement with the Internal Revenue Service (IRS) which establishes procedures which apply to all civil examinations conducted by PWBA and IRS involving employee benefit plans. This agreement provides that PWBA notify the IRS of plans selected for civil investigation, and defers action (not more than 20 days) to enable the IRS to inform PWBA that it has an open investigation and to request that the PWBA investigation not be undertaken.

Once a PWBA investigation is begun, PWBA notifies IRS of matters for which IRS has primary enforcement responsibility. Among these are prohibited transactions with respect to tax-qualified pension and profit-sharing plans, violations of ERISA's minimum funding standards, and evidence of discrimination in favor of select employees contrary to the requirements of section 401 of the Internal Revenue Code. The IRS has similar notification requirements with respect to matters for which PWBA has primary jurisdiction. The two agencies may, in appropriate circumstances, utilize special coordination procedures, including the conduct of joint investigations.

The Coordination Agreement further provides for continuing information exchange on matters at the National Office level. These include IRS advising PWBA of cases before an IRS Appeals Office concerning taxes assessed under IRC sections 4971 (minimum funding standards) and 4975 (prohibited transactions). Reciprocal notice is provided by the Department and the Tax Litigation Division of the IRS with regard to proposed legal actions on matters of joint concern.

Quarterly meetings are held between the IRS district offices and PWBA field offices to discuss referrals and special meetings are held whenever necessary to coordinate investigative activities. In January 1989, the Memorandum of Understanding with the IRS was amended to enhance the system for tracking referrals between the agencies. In 1989, 225 cases were referred from PWBA to the IRS. Our coordination efforts are not limited to working with the IRS, however. PWBA and the Office of the Inspector General/Office of Labor Racketeering (OIG/OLR) have been operating under a Memorandum of Understanding under which information is exchanged with respect to organized crime activity in the employee benefit plan field. PWBA also has a Memorandum of Understanding with the federal financial regulatory agencies -- the Federal Reserve Board, Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board and National Credit Union Administration -- by which these agencies refer to the Department suspected ERISA violations arising out of their audits. PWBA also receives enforcement related information from the Securities and Exchange Commission. A Memorandum of Understanding entered into between the Secretary of Labor and the Department of Justice provides guidelines for the investigation of criminal matters related to ERISA. In addition, PWBA field offices routinely confer with the local U.S. Attorney's office about specific criminal cases. Finally, PWBA meets and coordinates closely with the Pension Benefit Guaranty Corporation on matters concerning pension issues on a regular basis.

Coordination with state and local agencies is the responsibility of each PWBA field office. PWBA field offices have agreements with the various state banking and insurance commissioners which provide for the sharing of information obtained under their respective statutory authorities.

We are proud of the results we have achieved. In 1989, PWBA conducted a total of 1,581 investigations. Of these, 508 were concluded through voluntary compliance and 43 civil actions were initiated in federal district court. PWBA also closed 28 criminal investigations which resulted in obtaining 11 indictments. In the last 5 years we have closed 8,268 cases which resulted in the recovery of over $480 million for pension and welfare plans. Our targeting efforts, which I will discuss in more detail later, have been successful: we uncover ERISA violations in one of every three cases we investigate. We believe that in future years our enhanced targeting efforts will generate an additional stream of targeted investigations and generate even better results. I am proud of PWBA's enforcement results, and believe we have developed a highly effective targeting program.

While we have seen no evidence of widespread and systematic fraud and abuse of benefit plans, this is not to say there are no problems. There certainly are people who are negligent or indifferent in performing their fiduciary duties and there are some people who will abuse, embezzle from and perpetuate fraud against plans. For this reason we must always be vigilant in the enforcement of ERISA. As wrongdoers find new and more sophisticated ways to commit fraud and abuse, we have to find new and more effective ways to protect employee benefit plans.

Secretary Dole and I are committed to protecting the integrity of the private employee benefit system.

Having given you a general overview of PWBA's ERISA enforcement program, I would like to turn to action taken by the Department of Labor to improve its enforcement program.

III. ACTION TAKEN BY THE DEPARTMENT OF LABOR TO IMPROVE ITS ENFORCEMENT PROGRAM:

In order to establish policy direction and focus our enforcement efforts, in December 1986 PWBA issued an Enforcement Strategy Implementation Plan (ESIP), which establishes and describes the Department's enforcement strategy and objectives with respect to

ERISA. This strategy focuses our resources to deliver the greatest deterrent effect and to safeguard the largest number of participants and beneficiaries. We are currently in the process of updating the ESIP to reflect enforcement enhancements such as changes to the Form 5500 annual report, as well as the development and implementation of the ERISA Information System (EIS) and Case Management Information System (CMIS).

Our enforcement strategy focuses primarily on large plans (i.e., those with over 100 participants). While large pension plans constitute only about 6% of all plans, they represent nearly 90% of all plan participants and approximately 84% of all plan assets. We do not slight small plans, however. In order to leverage our resources, our targeting of small plans is accomplished indirectly by devoting 50% of our efforts to "significant issue" cases -- those involving service providers to employee benefit plans and financial institutions that act as fiduciaries to employee benefit plans. Most small plans are dependent on outside service providers such as consultants, plan administrators, banks and investment managers. Through this strategy an investigation of one service provider or financial institution may impact hundreds, and in some cases thousands, of employee benefit plans. Under this strategy, we completed 525 "significant issue" investigations in 1989. Over the last 3 years, we closed 1,013 such cases involving 119,000 plans and 11 million participants.

I would like to take a few moments to describe how our targeted enforcement program has been implemented. IRS service centers receive the Form 5500 annual report from the approximately 900,000 pension and welfare plans that are required to file. They key punch the data and subject it to a comprehensive series of automated edit tests to determine whether all of the required information is present. Interim edit reports are provided to the Department. This process identifies deficient filings and generates correspondence to the filer providing notification of the deficiency and requesting that it be corrected. If the deficiency is not corrected within 30 days a second letter is sent, followed by a third after an additional 30 days. This system just began operating this past summer. Early experience indicates that nearly 90% of the deficiencies have been corrected as a result of the first letter.

For those filings with deficiencies still remaining after three rounds of correspondence, civil penalties of up to $1,000 per day may be assessed under the authority provided in section 502(c)(2) of ERISA. This new statutory authority applies to all reports due for plan years beginning after January 1, 1988, and permits the Secretary to assess a civil penalty against a plan administrator who has not filed a report or has not satisfactorily corrected a deficient report. Regulations recently issued by the Department provide the filer with an additional period to correct the deficiency. If the filing is not corrected the civil penalties may be assessed. The first reports which are subject to the penalty, that is those that have already gone through three cycles of correspondence and are still deficient, should be available next month.

Once the automated edit checks are complete, the IRS forwards tapes containing all of the data to PWBA. The data for all 900,000 plans are then subjected to a comprehensive automated review using specialized targeting criteria. This new system is a major step forward. Prior to its implementation this year, we were only able to review a small proportion of all plans. Now, for the first time, all annual reports will be screened for accuracy and completeness, and subject to computer targeting.

PWBA developed these targeting techniques from experience in investigating ERISA violations. Annual reports which contain information which may be indicative of a violation are identified through this process, the report is flagged by the system and provided to the appropriate Field Office for follow-up determination of whether an investigation should be opened.

This sophisticated automation system, which also incorporates a case management information system, will allow us to conduct a review of all plan filings and maintain computer information on the investigations which are undertaken. This will enable us to considerably strengthen the deterrent effect of our enforcement program, better manage cases and evaluate the results of targeting and investigative techniques.

It will also improve the timeliness of our review. Because much financial and actuarial information is not generally available until after the plan year closes, ERISA does not require plan sponsors to file the Form 5500 until 270 days after the close of the plan year. This means that the report includes financial information relating to transactions that actually occurred as much as 20 months previously. The automated system ensures, however, that further delays will not result by giving us access to the information contained on the Form 5500 within 60 to 90 days after a completed Form 5500 is filed. Prior to this system, we had to wait as long as two years to have data available for investigations.

PWBA does not rely on computer targeting alone. We target additional cases for investigation in a variety of ways. Many of our cases are based upon leads gathered from individual Field Office initiated projects. Other sources of cases are information and complaints provided by participants, referrals from the Internal Revenue Service, financial regulatory agencies and other leads. Cases are also based upon referrals to Field Offices from our National Office. In combination, all of these targeting methods constitute a case selection process which is visually illustrated by the chart I have attached as an appendix to my testimony.

The effectiveness of this targeting system would be severely limited if the cases it generates were not investigated by well-trained personnel. All PWBA investigators attend training courses, which offer intensive training on such topics as fiduciary responsibility, investigatory techniques and plan accounting. The courses are taught by PWBA investigators and program officials, as well as private sector experts from the fields of finance and banking. This training is designed to give investigators specialized knowledge in areas related to ERISA enforcement. Advanced courses are conducted by PWBA in employee benefit plan accounting and investigative issues related to financial institutions.

In order to develop a heightened sensitivity to the potential criminal violations that may arise from our investigations, we have been increasing our specialized enforcement training relating to conducting criminal investigations. Selected management and staff investigative personnel have attended the White Collar Crime Training Program at the Federal Law Enforcement Training Center. Additional PWBA staff are scheduled to attend during the upcoming fiscal year. PWBA has also developed its own course on ERISA criminal enforcement in conjunction with the Department of Justice, the U.S. Attorney's Offices, and other criminal enforcement agencies. This course is being conducted this month, and will become part of our ongoing training curriculum for investigators.

We currently have open 68 criminal cases compared to 47 a year ago. This represents the largest number of open criminal cases in PWBA's history. With the increased emphasis on training in criminal investigative techniques, we expect our capabilities in this area to be further strengthened.

The new database targeting system and expanded training will significantly improve the effectiveness of the Department's enforcement efforts. Nevertheless, there are limits to the productivity increases which can be accomplished in this manner. Since ERISA was enacted in 1974, the total number of private employer-sponsored employee benefit plans has continued to increase steadily, and the assets held by such plans have increased from about $300 billion in 1974 to $2 trillion today. During this period, however, there has been no increase in PWBA staff.

On January 29, it was announced in the President's budget that we will be seeking 100 new positions for civil and criminal enforcement of ERISA, a 33 percent increase in our enforcement staff. This represents the largest increase in enforcement positions since ERISA's enactment and should significantly enhance our ability to enforce ERISA. We anticipate that the increased staff will enable us to conduct as many as 1000 more investigations each year. In addition, the Administration is seeking 33 additional Department of Labor attorneys to prosecute ERISA cases. This major increase in staff is concrete evidence of the Administration's commitment to strong and effective enforcement of ERISA.

While I believe our record is one of accomplishment, there are also ways in which ERISA itself could be improved to enhance our ability to safeguard plan assets and protect the rights and interests of plan participants and beneficiaries.

Secretary Dole has directed a thorough and comprehensive review of all Departmental enforcement strategies and activities. Particular emphasis has been placed on criminal enforcement and its proper role within the Department's overall enforcement strategy. This enforcement review was designed to identify areas where enforcement strategies and activities can be enhanced and underscores her vigorous commitment to fulfilling the Department's enforcement mission. This review will be completed this summer.

The Department's Office of the Inspector General has made a number of recommendations concerning ERISA enforcement. In response to those recommendations, PWBA reviewed proposals regarding the work of independent public accountants (IPAs) who audit employee benefit plans, including proposals to repeal the limited scope audit exception, require compliance audit testing, and require peer review of IPA's work.

Our review extended beyond the recommendations of OIG, however, to address a number of issues related to providing additional incentives for participants and beneficiaries to exercise their private rights of action under ERISA and to strengthen the disincentives for unlawful behavior. Our review of ERISA enforcement concluded that, although the addition of new enforcement positions included in the President's budget will increase both criminal and civil investigations under ERISA, a number of statutory changes are also warranted. The Department's conclusions can be summarized as follows:

(1) ERISA should be amended to repeal the limited scope exemption and that a provision which enables plans and financial institutions to utilize a "single audit" approach be enacted.

(2) ERISA should be amended to add a requirement that Independent Public Accountants (IPAs) obtain a peer review every three years in order to be considered qualified to conduct required ERISA audits.

(3) ERISA should be amended to require the award of expert witness and attorney fees to successful plaintiffs alleging fiduciary violations of ERISA.

(4) ERISA should be amended to allow the Secretary to award a portion of the civil penalties assessed under the new section 502(l) for a fiduciary violation of ERISA to the individual who brought information to PWBA regarding the violation.

(5) Existing excise tax penalties under section 4975 of the Internal Revenue Code and civil penalties under section 502(i) of ERISA for prohibited transactions should be increased from 5% to 10%.

(6) ERISA should be amended to require de novo judicial review in benefit claims cases where conflicts of interest exist.

(7) ERISA should be amended to require multiple employer welfare arrangements (MEWAs) to file annual registration statement with the Department and to certify that copies of such statements have been sent to State Insurance Commissioners in States where they do business or intend to do business.

(8) ERISA should be amended to require plan fiduciaries to disclose to participants and beneficiaries the proxy voting record of stocks held by plans.

At this time we are not recommending legislation to expand audits to include compliance testing and to require the direct reporting of violations to the Department of Labor. We have instead made a joint proposal with OIG to the American Institute of Certified Public Accountants (AICPA) for voluntary adoption of needed changes. We agree with OIG that the voluntary adoption of compliance-testing requirements by the accounting profession is the best approach to achieve our objectives. I am pleased to report that negotiations with the AICPA with respect to changes to their audit guides for employee benefit plans that will satisfy our interests appear to be progressing favorably.

A few brief additional comments relating to these proposals is appropriate. We view the criminal and civil sanctions that are available under ERISA as providing a range of enforcement tools. Neither criminal nor civil sanctions are inherently superior to the other in all situations. For example, criminal sanctions may punish wrongdoers and have a deterrent effect, but require a significantly higher burden of proof than civil cases and do not by themselves necessarily make plans whole for losses incurred. Civil cases are easier to bring, can join all Defendants in one single action, and are more likely to result in making the plan whole. However, they do not have the deterent effect that a criminal action has against a willful wrongdoer. Different sanctions are suited for different situations; we seek to pursue the appropriate remedy for a given situation.

The legislative proposals I outlined are consistent with this view. They are designed to provide additional methods of improving ERISA enforcement. They should be considered in this context. For example, increasing excise tax and civil monetary penalties should be considered because they would provide an increased deterrent to wrongdoing, not because they would raise revenue. Similarly, these proposals are not designed to improve the financial status of the Pension Benefit Guaranty Corporation. The underfunded pension plans which pose the greatest threat to the PBGC are not underfunded because of fraud or other criminal activity. While the PBGC frequently pursues fiduciary breach claims in its capacity as trustee of terminated plans, the amounts involved are not a significant contributor to PBGC's deficit.

I am confident that enactment of these statutory changes, coupled with the increase in staff contained in the President's budget, and the steps already taken to improve our enforcement efforts, will greatly improve the quality of ERISA enforcement.

Before I conclude my prepared statement, I would like to take a few moments to comment on recent concerns regarding common areas of abuse for welfare plans.

IV. COMMON AREAS OF ABUSE FOR WELFARE PLANS:

ERISA enforcement is frequently thought of in terms of pension plans, in part because the vast majority of assets held by plans subject to ERISA are in pension plan trusts. Although welfare benefit plans represent a smaller pool of plan assets, they still pose a number of issues regarding ERISA enforcement.

PWBA recognizes the potential for abuse of welfare benefit plans. As mentioned earlier, the ESIP devotes 50% of PWBA's enforcement efforts to two specified "significant issues" enforcement priorities, one of which is service providers to employee benefit plans (especially health and welfare benefit plans).

An issue relating to welfare benefit plan enforcement that has received considerable attention recently relates to multiple employer welfare arrangements (MEWAs), which appear to be particularly susceptible to abuse. MEWAs (also referred to as multiple employer trusts, or METs) are group trusts used to fund welfare benefits, especially health insurance, typically for small employers. We regard the potential for abuse of MEWAs as a serious problem, in part because MEWAs are difficult for both Federal and State authorities to identify and regulate.

In all candor, however, I must tell you that neither we nor anyone else has an accurate picture of the scope of the problem. In an effort to improve this situation, the Department has proposed that ERISA be amended to require MEWAs to file an annual registration statement with the Federal government to help identify these arrangements. We are also taking steps to strengthen our coordination efforts with State insurance departments and other law enforcement agencies to ensure that States are able to identify MEWAs that are subject to State insurance laws.

V. CONCLUSION:

In conclusion, I would like to reiterate that Secretary Dole and I are committed to strong enforcement of ERISA. America's private work force must be assured that promised benefits will be delivered. Over 70 million Americans depend on the Department of Labor to protect their hard-earned benefits and I want to assure the American people that we will do just that.

Chairman PICKLE. Secretary Ball, we thank you for this very helpful information and the suggestions that you and Secretary Dole have given us. It shows us strong leadership, and we appreciate that.

And we thank you, Mr. Brauer.

Now, the House has a vote on at this point, and we have only a few minutes. I am going to have to declare a recess for about 10 or 15 minutes. We will be back as soon as we can.

[Recess]

Chairman PICKLE. The Chair would ask the subcommittee to come to order again.

I want to thank you again, Mr. Brauer and Secretary Ball, for your testimony, your statements. It's very helpful and very valuable information.

Secretary Ball, have you gotten any response from the various groups with respect to the proposals you are recommending? In your testimony, you have recommended some six different recommendations of the Department of Labor for improvements.

Are all the agencies in agreement with those proposals, or do you know?

Mr. BALL. I don't know of any disagreement with these proposals. Certainly, the PBGC has been very much involved and very closely informed, and I know of no disagreement by the IRS with regard to these proposals.

So I believe we have support. Of course, they have been cleared within the administration, and I also believe that we have support on both sides of the aisle on the Hill, too.

Chairman PICKLE. Do you have the support of the accounting profession?

Mr. BALL. The accounting profession, I believe, supports us with regard to the limited scope exemption and with regard to requiring peer review every 3 years. We are in the process of negotiating with the accounting profession on the issue of compliance testing, and we have made good progress on that. But we have not reached a final conclusion.

Chairman PICKLE. Do you have the cooperation of the inspector general in these particular recommendations?

Mr. BALL. The inspector general supports the two accounting proposals, and we are working with the inspector general again in trying to persuade the accounting profession to adopt some form, on a voluntary basis, of compliance testing.

So, yes, we are working together with the inspector general on the three financial proposals.

Chairman PICKLE. Well, throughout your testimony you seemed to give the indication that the Department of Labor is auditing and properly targeting cases now, and that enforcement is being sought and obtained, and that there is no need for additional emphasis on criminal approach.

Is that a position that is different from the inspector general?

Mr. BALL. Well, the inspector general is going to testify later, and I believe he may have a different emphasis than what we do.

When we conduct our investigations, we don't distinguish between civil and criminal violations. We just conduct an investigation, and we pursue that investigation wherever it's going to lead.

Now, in most cases, it does lead to a civil remedy of some kind. But if we turn out evidence of criminal wrongdoing, we work with the U.S. attorney. We have available through the U.S. attorney the resources of the FBI and all the wonderful work they do, and we will pursue relentlessly criminal investigations.

As I mentioned in my testimony, we are have right now, more open criminal investigations than last year and probably than at any time in the history of PWBA.

Chairman PICKLE. I notice in your testimony, and I did make a general observation, that you point out the number of cases that you settled, the plans you audited, the fines you imposed, and the revenue you obtained from it.

I also noticed in the President's budget this year, and somewhere in your testimony, that you accounted for $64 million for new revenue that is in our budget.

Now, the emphasis seems to me that in order to protect plan assets, you are imposing fines and that you are investigating and getting the money protected, but that the emphasis then is on civil action.

And you raise a good bit of money because of this, as you brought it out in your testimony. Does that mean that you are emphasizing this and not the criminal approach?

Mr. BALL. We feel it's extremely important to get restitution for plan participants, and so in the work that we do, we place a great deal of emphasis on that.

We want to make sure that people get their money and are paid their pensions, and it's true that ERISA is primarily a civil statute. But we never want to give the impression that we disregard the criminal remedies and criminal sanctions.

They are very important.

Chairman PICKLE. Earlier one of our members, I think it was Mr. Chandler, raised a question, have we driven out a lot of the small plans?

Have we, through regulations and through stiffer funding requirements, caused a great many of the small plans to just cancel the plan and say, we are not going forward on it?

Has that been a significant number, or are we in better shape than we were? What is your overall view about the direction we have taken 2 years ago and where we are today?

Mr. BALL. Well, there has been a succession of new laws and regulations in the pension benefit area. These have had an impact on the willingness of employers to sponsor defined benefit plans. The complications and the demands of a defined benefit plan are very onerous, and I think that is what Mr. Chandler was referring to.

What we are seeing is that although the big, defined benefit plans are being maintained, the real growth in pension plans is in defined contribution plans.

Chairman PICKLE. Well, I hope that we are not driving out many of the small plans. I think we have probably put the emphasis on that there were a lot of plans that were underfunded, and that we had to make that correction.

And I think probably, I want to believe that the system is in better shape today because of these changes, but also that the opportunity is still there for inauguration and continuation of a plan.

Mr. **Ball**. Yes. Mr. Chairman, actually, the changes with regard to funding occurred in 1987 largely with the leadership of this committee and your participation was extraordinarily helpful. I was not referring to those changes.

I think they have been very beneficial to the pension system.

Chairman **Pickle**. Well, I am glad to hear that, and the committee will be glad to know that that is your view of it.

Now, Mr. Brauer, either you or Secretary Ball, I would like to know how the PWBA actually plans for an examination and what percentage of plans examined are found to be in violation of ERISA?

Is the funding status of the plan a factor in determining whether it should be examined? If so, is the funding status of the plan available on the form 5500 data base, and is this available through PBGC, or is it obtained there?

In other words, where do you get the funding data shown on the form 5500?

Mr. **Brauer**. Well, funding assumptions, Mr. Chairman, are matters we look at when we examine a plan. There is various material submitted when the 5500 form is filed on a schedule B, which is actuarial information, and we use that information in the funding assumption area as one basis to examine plans.

I am not sure that that answers your question. But funding assumptions, once again, are subjects for examination, and they are submitted on the schedule B.

Chairman **Pickle**. All right.

Mr. Schulze, do you have any questions of the Secretary or Mr. Brauer?

Mr. **Schulze**. Mr. Chairman, yes, I do, and I am going to try to consolidate them in the interest of time.

As a follow up to the chairman's line of questioning about small pension plans decreasing, or new pension plans not starting because of complexity, Mr. Secretary, I don't know whether you really thoroughly answered the question.

I would like to try to determine that because quite frankly, in my opinion, I believe that our actions have had a dilatorius effect, and that perhaps there are fewer people under pension plans, but perhaps those pension plans are better or more secure.

I would also like to have your opinion as to whether there are fewer and whether we are actually driving pension plans out from the small businesses.

Mr. **Ball**. Well, the effect of the proliferation of regulations has been primarily on stopping the growth of defined benefit plans. Defined benefit plans, Congressman Schulze, leave the risk, as you know, with the company. The shift that has occurred towards defined contribution plan is in some ways undesirable, or less desirable, because the risk is on the participant.

Mr. **Schulze**. Isn't that a natural process, though, from what we have done?

Mr. **Ball**. It's a process that is happening in the marketplace, and at the same time, while there has been little or flat growth on the defined benefit side, there has been a tremendous increase in defined contribution plans.

And it's apparently a response to the marketplace. Participants do like to have control of their own individual accounts, which is possible with a defined contribution plan. So reasons other than regulation that are causing this trend.

Mr. **Schulze**. Well, that leads me to Mr. Brauer, and I have in my hand the proposed regulations for the nondiscrimination rules under form 5500. I have to say just looking at them, that has to have a discouraging effect on someone who is thinking about wading through this stuff.

Did you take this into account when preparing these regulations, also the idea that someone would not only know or be able or perhaps inadvertently violate these provisions? It's almost unbelievable to me that we could not consolidate those regulations.

Mr. **Brauer**. Congressman Schulze, what can I say except that I think we all agree that simplification in the pension area is vital. I mentioned in my testimony that we have had 15 changes, many of them substantive changes in the statute, since the ERISA statute was enacted in 1974.

That is on average 1 a year, and many of them were close to complete rewrites of the old statute.

I looked the other day to see how many regulations, notices, revenue rulings the Service has issued in each of the last several years. The number is staggering.

I know that the Commissioner joins me, the Assistant Secretary for Tax Policy joins me in urging that we all get together to attempt to simplify this law.

Mr. **Schulze**. Is there a program for that? Is there a plan for that?

Mr. **Brauer**. I know this is a matter of active consideration, particularly as regards particular regulations that we have to come out with.

Mr. **Schulze**. It's under consideration, but we have not really set up a plan or a program.

Mr. **Brauer**. I also know that there is impetus on the outside from the private sector to try to get in and look at them.

Mr. **Schulze**. I can understand that and I believe it's imperative. If this committee talking to the Commissioner will help, I will be happy to do it because this will discourage small businessmen from going into a pension plan.

Now when we started this a couple of years ago, I said if I were still back in business that I would probably start giving my employees two pay checks, and we don't want to do that. These are your fringe benefits, and here's your salary, but we just don't want to drive the business community to doing that.

I am afraid we are heading in that direction. So if the Commissioner is working on simplification and we can get everybody together, I would strongly recommend it. I believe it's absolutely imperative that we do that.

Mr. Chairman, in the interest of time, I will stop there.

Chairman **Pickle**. Well, I thank you, Congressman Schulze.

Let me see those forms in the meantime.

Mr. **Schulze**. You got that? That is awfully heavy.

Chairman **Pickle**. Well, I can lift them, but I admit that this is very cumbersome, and we ought to put it back here.

Mr. Chandler, do you have any questions?

Mr. CHANDLER. I don't have anything to throw around. I feel left out.

All right. Mr. Brauer, I believe the point that you just made really needs to be underlined—the 15 major changes since ERISA was passed in 1974, nearly one a year, that was not the Department of Labor, that was not the Internal Revenue Service, that was the Congress of the United States that made those changes.

To the extent, I believe, that many times when we righteously condemn both Departments for not even staying up with the requirements of the law for issuing regulations, really we ought to look in a mirror and put a sign up above it that says, you are looking at the problem, Congressman, and we need to take a look at our our behavior in this regard.

Let me suggest that this question about the small plan issue is one of considerable interest to the members of the committee. It certainly is to me. I need to better understand, if you can help me, the question of assumptions for determining contribution limits, actuarial assumptions.

Who makes the assumptions for the plans, for the plan sponsors? Who makes the assumptions for the IRS and who determines who is right, and how does that happen?

Mr. BRAUER. Generally, as I understand it, the assumptions for the plan are made by the actuary or the pension consultant.

Then the Service, in an examination posture, sometimes questions those assumptions, and I believe the basic statutory provisions, are under section 412(c) of the Internal Revenue Code, and I know there is some controversy concerning the degree of reliance the Service should place on the assumptions used by the actuary or the pension consultant.

And I believe our view on that is that we basically are required by the statute to question assumptions in certain cases, and that is what we are doing as part of this program.

Mr. CHANDLER. How often does a plan sponsor update assumptions used in the plan?

Mr. BRAUER. Well, plan assumptions—as opposed to funding assumptions, plan assumptions generally are fairly well fixed once they are established. Funding assumptions change more frequently, sometimes every year, sometimes less frequently than that.

But one has to make a basic distinction between types of assumptions.

Mr. CHANDLER. If you are planning for your annual contribution, you have to assume a certain interest rate return, average retirement age, changes in the amount of work force or whatever?

Mr. BRAUER. If you are referring to the funding assumptions which I think you are, my understanding is generally the actuaries look at that area with regard to a particular plan pretty much each year.

I don't know that it's required each year, but they pretty much do it on that basis.

Mr. CHANDLER. On the tax return that you examine, is there any way for you to identify the actuary that made those assumptions?

For example, an accountant will have an identification number so the IRS would know who it was that filled out those plans. Is that true of an actuary?

Mr. **Brauer**. We are able to identify, and I am not sure offhand whether there is a number—there is a number for the actuary. I believe it's called an enrollment number. I don't recall offhand whether that is included on the schedule B being submitted to the Service, but we do have a way of identifying particular actuaries in situations, particularly where we feel there is a particular abuse involved.

Mr. **Chandler**. Have you noticed any particular pattern of misassumptions based on that identification of the actuaries?

Mr. **Brauer**. Yes. We have noticed, in some cases, particular actuaries seem to use patterns over and over, what we would describe as abusive patterns. And in those situations, we tend to look a little further into the work that that actuary has done.

Mr. **Chandler**. And that is part of this small business, or small plan sponsor process of examination that you are talking about?

Mr. **Brauer**. Yes, indeed. That is part of the program. There are many, many cases you should understand that do not involve patterns. Basically, as I believe you are aware, we consider each and every case on its merits, and we look at every case based on the situation presented in that particular case.

But once again, there are certain actuaries, based on your question, that do use particular assumptions over and over again, the same assumptions. Remember, we are supposed to be dealing with a situation, we look at the particular plan involved and determine, based on the facts and circumstances of that plan, what assumption to use.

That is what the actuary is supposed to do, and that is not always done.

Mr. **Chandler**. The GAO testified that they thought much of this was more driven by the potential for revenue collection than any actual abuse.

Mr. **Brauer**. I can assure you that that is not the case. The item is indeed in the President's budget, but this is a matter from our prospective of abuse, and we intend to look at these plans from that perspective, once again judging each case on its merits.

Mr. **Chandler**. I was heartened by your testimony that you do not find widespread violations of criminal tax provisions which IRS is enforcing. You also said our agents also find a relatively small number of instances of back dating of plan documentation.

I think back to what we were saying earlier, that while obviously any fraud is clearly something we want to try to prevent, what you are suggesting here is that is a very small number of instances out of the thousands of plans involve fraud.

Mr. **Brauer**. I think it used to be a greater problem than it is now. I really believe that with the increased cooperation of the agencies involved in enforcing the ERISA statute, and the increased resources the Service is spending on enforcement, that there is an understanding out in the community that the Government is there, we are regulating the area as we should be, and that some of these abuses are stopping.

Mr. **Chandler**. Mr. Chairman, I will suspend there. I may have some other questions, and we can submit those in writing, perhaps, and then submit those for the record.

[No questions were submitted.]

Chairman **Pickle**. Mr. Chandler, I wish to ask additional questions. I will return to you, if you wish, you and Mr. Schulze.

Now, Mr. Brauer, I asked you a few minutes ago, was the funding status of a plan a factor, when it's being examined, was this funding information in the data base?

And you said well, when we go into these cases, that we find the funding data very helpful.

Is that information available in the data base with respect to form 5500?

Mr. **Brauer**. The information, Mr. Chairman, as I mentioned earlier, is submitted with the schedule B of the form. Some of the schedule B information, I know, is inputted into our computerized data base.

Chairman **Pickle**. But it's not in the data base, is it?

Mr. **Brauer**. Basically what we then do as a result of that is secure the return to see if it's provided.

Chairman **Pickle**. Mr. Secretary, you have indicated that you made all these big changes, you remade the world on these plans and all this now is in the computer.

Is that in the data base, all this information, funding information; is that in the data base?

Mr. **Ball**. Well, the form 5500 does have a schedule B to it, as Mr. Brauer was testifying, that contains plan information, including the assets, the liabilities, and information with regard to the funding assumptions, so that the information is available.

There is no evidence, Mr. Chairman, that there is a correlation between underfunding and ERISA violations. And it's not something that we target.

Chairman **Pickle**. Mr. Brauer, in your written statement to this committee a few minutes ago, you said that your selecting plan, or your plan for selecting a plan that would be audited, and I agreed that you don't have effective means now of targeting your examination efforts.

Now, if that is so, it would seem to me like you just are really not certain who you are auditing, and on what you use as a basis for auditing.

I don't want to say you are just kind of wandering around in the dark, but—and you do find some cases that are worth looking into, but in my country we say, you know, a blind hog can find an acorn sometimes.

And I am just asking you, is it really that inept at this point? Do you really have a good system of targeting which case you should go after?

Mr. **Brauer**. My response, Mr. Chairman, would be that I think we have a good system, and I think it has a way to go before it's a very good or an excellent system.

I do think, for example, with regard to our special emphasis programs, for example, the small plan actuarial program, that it is no doubt an effective program, if not a program that everyone appreciates in its entirety.

But I do think we have a way to go, in getting away, for example, from our TCMP data.

Chairman PICKLE. I am glad to see you have a way to go. I had the feeling that we ought to just lay down our crutches and go back to the ranch and not worry about anything.

We have got a long way to go with respect to public use of funds.

Now, yesterday in our hearing, nearly every witness, particularly people who had been affected by these plans, they said the form 5500 was of very little value to them.

Why would they say that? What is your comment about that? That is uniform. I don't know of everybody who actually has been brought up or whose case was looked at, who said that form 5500 was very much help to them.

Where is that big pile? But this is the type of thing that we are faced with.

What does an average participant do when his plan has been canceled or has been shortchanged, or he had to hire a lawyer, and if he wants to question the system, how does that individual start? What relief is there? How do you go about it? Can you comment on that, either one of you?

Mr. BRAUER. Well, certainly one way, Mr. Chairman, would be if there is a concern with whether the individual is receiving the benefits to which he or she is entitled, one should approach, it would seem to me, one of the agencies involved in enforcing ERISA to see if there can be redress, if there is a concern there.

And I know the Service receives and I am sure the Department of Labor receives many such requests each year from participants of plans.

Chairman PICKLE. Well, I am not satisfied that if I were a plan participant and I thought something was going wrong with my plan, I would know where to start. Every time they try to start, they get knocked back.

It seems to them the Federal Government is the last source of some response. Is that the average feeling that you think is experienced out there, Mr. Secretary?

Mr. BALL. Mr. Chairman, there are two comments. Number 1, the six cases that you heard about yesterday involved an old form 5500, before the new form was put into effect.

The new form is only applying for years 1988 and beyond. We believe the form is being significantly improved and does have comprehensive information. Not only that, but we have immediate access to it and will be able to act on it. So, the form is better.

Second, with regard to people having problems, the first place they have to go is to the plan document itself. There is a summary plan description that is available to all participants. There is also the summary annual report of the financial condition of the plan.

If participants have difficulty in understanding the plan, then they can go to the plan administrator, and in millions of cases throughout the United States when people have questions about their pension plans, they go to their plan administrator.

And that system is working, and of course, as Mr. Chandler was saying before, you don't hear about the wonderful job that companies throughout America are doing in servicing pension plans and providing help to their participants because that doesn't make news.

You hear about the bad news. But where there are problems and help is not available, then there is a resource: we do have a public assistance office.

In 1989 PWBA's national office handled 67,000 inquiries from people asking for help. Our field offices, in addition to that, handled another 73,000 inquiries. So, over 100,000 people got help who could not get help from the plan administrator.

Now, this is with regard to the Labor Department. I believe the Internal Revenue Service has its own program.

Chairman PICKLE. I am not going to, for a moment, say that you are not furnishing information to people who request it. But the cases that we have had before us specifically, and as our staff talked to different plan participants across the country, almost uniformly they say that form 5500 is not very much help to them.

Now, perhaps that is the old form. Let's hope that the new form is of specific help to them. But let me give you an example now of this, of part of our testimony yesterday.

We had a Mr. Weiler testify that in the Modern Dairy Farm case, he was testifying for the IRS, and he told us that excise taxes were levied against Herbert Freel, the plan trustee, and he had embezzled all the assets, and that they had leveraged him based on the Department of Labor's file, and that the IRS did not do any audit or investigative work of its own.

Is that normal?

Mr. BRAUER. Yes, that is typically how the system works.

In this particular case you are referring to, the investigative work was done by the Department of Labor. As I believe you know, Mr. Pickle, the two agencies have a joint compliance agreement under which, in the interest of reducing burden to the taxpayer as well as avoiding duplication of effort, one or the other of us conducts the examination.

Chairman PICKLE. All right.

Now, Mr. Brauer, I noticed yesterday in this same particular case that Mr. Day, Jesse Day from the Miami Department of Labor, PWBA office, said that his statement, only this was the Visual Scene case, that the Internal Revenue Service had imposed excise taxes of $22,000, in that particular case.

Now, is this just another example of an excise tax where all the IRS did was to act on PWBA's work?

Did you do any work on it at all?

Mr. BRAUER. That particular case that you are referring to, if it was Modern Dairy, my recollection is no, we did not do work. And essentially we were doing what we had to do, which was impose the excise tax. That is the nature of the examination in that sort of a case.

Chairman PICKLE. All right.

But now it seems to me we have to make the observation that both Internal Revenue Service and the Department of Labor didn't get into the case until the pension money was gone. Is that correct?

Mr. BALL. In that case, there was embezzlement, Mr. Chairman, and, of course, when people commit fraud and abuse, you have a different kind of a problem.

The point that you are making, we actually agree with you completely, and that is why Secretary Dole has made this legislative initiative proposing ways to strengthen enforcement to provide incentives for use of the private right of action to get individuals involved, to have additional disincentives for wrongdoers, and to strengthen the auditing and the accounting functions.

So we actually agree with you that more can be done, and we want to do more.

Chairman PICKLE. Well, I hope these recommendations will make an improvement, but the fact of the matter is in this particular case, and in many, many cases, we don't get into these examinations or audits until the money is all gone, and I would have to say, at this given point, of the 900,000 plans out there, there are many other plans where the money is being siphoned off or embezzled or misappropriated, and you don't know it.

That should be a bother to us, so I would say to you on the recommendations, I would hope they would give us an approach that we could make those kind of corrections because it is important that we do that. Now, we are not trying to be overly critical. Obviously, with that many plans, you can't assume that everybody who is running the plans are conducting themselves in a very Christian manner, because we know that sometimes the dollar is stronger. But, I just—I want to know what can you do to catch some of these before the money is gone, and maybe these recommendations will be of help to us.

Mr. BALL. Plus the additional staff, Mr. Chairman. We do need to conduct more investigations. We believe that with the 100 additional people in the enforcement staff we will be able to conduct 1,000 additional investigations per year.

Chairman PICKLE. That is impressive, and I sure hope that will help, and that we will find ways for the individuals who make inquiries to get satisfaction.

Yesterday we had one individual who was complaining he could not get information from anybody about the many plans he had. He had a plan that has been taken over by another group, and they had made changes in the basic assumptions or benefits ratio, and he has been trying for years and years to find out what he is entitled to, and every time he goes there, they say it is not our problem. It is not Labor, it is not IRS, go get a lawyer, and he had finally gotten a lawyer, and he is now appealing for what he thinks is just. He is asking for information.

Is that typical of many individuals out in the pension world? Are you familiar with the case that was involved yesterday?

Mr. BALL. I am not.

Chairman PICKLE. Mr. Brauer, are you?

Mr. BRAUER. I am not terribly familiar with that case. I do know that participants do have trouble sometimes getting information. If the case you are referring to is the case involving United Technologies, is that the case, Mr. Chairman, that you are referring to?

Chairman PICKLE. Did you want to——

Mr. BRAUER. Let me tell you what I know about that case if that will be helpful to you, Mr. Chairman. The United Technologies case involved a—at the point we first saw it in the IRS, a congressional inquiry from Congressman Drier on behalf of Mr. Englehardt in June of 1988.

Chairman PICKLE. Well, he did contact Congressman Drier, but that didn't help him, either.

Mr. BRAUER. That's correct. Unfortunately it did not. Let me tell you what I know of the case. We replied to the letter of the Congressman in July, our Brooklyn district director did, and invited Mr. Englehardt to write to our district office with information that would be sufficient for us to evaluate the concerns, and then we did not have a record of receiving any further information, even though I am aware, based on the testimony yesterday that further information was indeed submitted to us. And all I can say is that I apologize for the fact that we apparently did not receive it or do not have a record of it.

We will be happy to look into the matter for the gentleman.

[The following was subsequently received:]

Our office has referred this matter to the EP/EO Key District in Brooklyn for handling. That office may reply directly to Mr. Englehardt.

Chairman PICKLE. Well, I am sure we got many other cases similar to Mr. Englehardt's. I simply am asking myself how does an individual find out about his plan? Where can he get the information, and though you may receive 65,000 cases or calls last year from some 70 million people out there, they are wondering, many of them, is my plan firm? Is it solvent? Will my money be there and have they made any changes?

I think we have to admit that what you do is you emphasize the civil approach as against criminal, but I would agree that there must be a fine line there.

We ought not be approaching these cases to scare people because that would be damaging to the entire pension system, and Mr. Ball, you are saying overall the plans are being well-audited. They are now being targeted, you do have the solvency funding information in the data base and that from now on we ought to have a much better accounting of these plans; is that correct?

Mr. BALL. Yes, sir.

The pension system in the United States has never been healthier, but we have room for improvement. The staff is stretched thin. We need additional staff. With the proposals that Mrs. Dole has made to strengthen the enforcement, I believe we will go a long way to reaching these problems that concern you.

Chairman PICKLE. Well, I hope you do, but in both of the criminal cases that we looked at yesterday, the PWBA had completed your civil examination before you ever went into the criminal aspect.

Is that normal?

Mr. BALL. As I said earlier, Mr. Chairman, we don't distinguish when we begin an investigation between civil or criminal. We just conduct an investigation, and we take that investigation wherever it will lead us. Because the matter frequently involves restitution to the plan, it often is the case that we, first of all, pursue a civil remedy, but if we identify in the course of our investigation a criminal matter, we immediately get hold of the U.S. attorney.

We work with the U.S. attorney in pursuing the civil case, and we have available through the U.S. attorney, the resources of the FBI and other resources of the Federal Government in pursuing the criminal investigation.

Chairman PICKLE. Well, let me ask you one question. This is a very broad question. Years ago I was with the Commerce Committee, and we had started some of the investigations of the Central States Pension Fund, and then, when I became a member of this committee, we continued that. And I like to believe that our subcommittee started the intense examination of the Central States Pension Fund.

What is the status of the funding position of the Central States Pension Fund at this point? Do you know?

Mr. BALL. I have with me my deputy, Alan Lebowitz. I would like him to respond to that question.

Mr. LEBOWITZ. Mr. Chairman, I don't know specifically what the funding level is of the Central States Fund. I can tell you that the reforms that were put into place following our extensive investigations and the litigation that ensued and options by the Internal Revenue Service have changed that plan's situation dramatically.

My general impression is that it is well-funded and that it is operating in a rather exemplary fashion now.

Chairman PICKLE. Well, I had understood in some of these simpler cases now they actually got underfunded plans and they purposefully keep some of the plans underfunded so that they can force them into continuing union membership, and unto other activities, but that is another question that we will be looking into later.

Well, I want to thank you. I don't have any other questions. I want to ask if any of the subcommittee members, if they are here. If they have any questions. I do appreciate your attendance here and your testimony.

Secretary Ball, we are going to be very interested in getting a reaction now from some of those other panelists of what their reactions are to the recommendation made by Secretary Dole.

We hope you or your representative will be here with us as we go forward. Thank you very much.

Mr. BALL. Thank you, Mr. Chairman.

Chairman PICKLE. The next panel will be Raymond Maria, who is the Deputy Inspector General of the Department of Labor. Mr. Maria, if you will come forward. Mr. Maria, if you will proceed, your entire statement will appear in the record.

STATEMENT OF RAYMOND MARIA, DEPUTY INSPECTOR GENERAL, U.S. DEPARTMENT OF LABOR

Mr. MARIA. Thank you, Mr. Chairman.

Some 14 months ago the inspector general first registered his concern about employee pension and welfare benefit plans' increasing vulnerability to fraud and abuse.

We attributed this vulnerability to four basic factors: the inability to integrate the work of the independent public accountant into the overall enforcement equation, the size of the universe compared to the number of enforcement people available at the Federal level, the fragmented enforcement process within the Department of Labor, and indeed what we consider to be one of the more critical factors, a flawed enforcement strategy.

I would like to spend just a few moments discussing each of these factors. We have heard extensive testimony about the role of the independent public accountant and the requirement that there be an audit in those plans with over 100 participants.

Given the size of the universe, some 900,000 private pension plans, joined by some 4.5 million welfare plans, the role of the independent public accountant is very critical, almost a first line of defense in ferreting out and detecting irregularity and indeed in some instances violations of ERISA or indeed violations of related title 18 United States Code provisions.

With respect to the role of the independent public accountant, we and the Americana Institute of CPA's have endorsed legislation that would remove any limitations on audit scope, thus making all assets available for audit perusal at the discretion of the independent public account.

A bill has been introduced in the Senate which would accomplish that. Now, with respect to improving the audit process, the Office of Inspector General, Pension Welfare Benefits Administration, and the American Institute of CPA's have been conferring regularly now for nearly the past year.

My colleagues in the Office of Inspector General have been dealing directly with the Auditing Standards Board, the American Institute of CPA's, and from these discussions I am cautiously optimistic will emerge an improved audit guide for employee benefit plans, one which will provide procedures to be followed by independent public accounts who undertake benefit plan assignments.

I want to be emphatic that this is an audit guide done within the framework of a financial statement audit. It is not a compliance audit. We believe that if the audit work is done properly, if meaningful and if realistic procedures are incorporated into the audit guide, then indeed we will have a process which will serve the enforcement function.

We do not, in the Office of Inspector General support, nor are we considering at this time any legislation which would require a different kind of audit or compliance auditing as other witnesses have testified.

Chairman Pickle. What is your position with respect to a peer review by, say, the Independent Accounting Board?

Mr. Maria. We do endorse the recommendation that within a 3-year period, or each 3 years, those public accounting firms that take on employee benefit plan assignments should be subjected to a peer review.

The second factor: the size of the universe. There is a tremendously broad universe, and I believe the testimony has been that the Pension Welfare Benefits Administration has approximately 300 people to address that universe.

The end result is that fewer than 1 percent of the plans are even examined on a cursory basis. These are fairly inviting odds to those who are unscrupulous. I want to be emphatic on this particular point.

The inspector general has never said that fraud, corruption, and abuse are widespread. What we have said is there are circumstances present which are an invitation to larceny. Crooks and thieves know the odds very well; 900 private pension plans, 4.5 million welfare plans, 300 people in the Pension Welfare Benefits Administration. I think it is something that we must be cognizant of and if we realize the odds, if we appreciate them, as do those who have criminal inclinations, then we can take steps, serious steps to close those gaps.

Mention has been made of how many people in the Pension Welfare Benefits Administration. I think it is instructive to note that the Office of Inspector General has approximately 100 special agents in his Office of Labor Racketeering who, on an annual basis, devote about 65 percent of their effort to employee benefit plan corruption.

As of the end of last month, the Office of Labor Racketeering, through its investigations, has achieved the convictions of 315 individuals for benefit plan corruptions. Not one of these investigations arose from anything contained in the form 5500. The plain and simple truth: crooks do not tell the truth when filing applications or completing forms.

Ninety percent of these benefit plan investigations, Mr. Chairman, involve welfare plans, which from our study are even more vulnerable to abuse than pension plans. You can track assets in a pension plan, but by and large welfare plans, which provide such services as medical, dental, optical, legal assistance, alcohol, drug and rehabilitation counseling, are a cash in-cash out operation.

There are many of them, nearly 4.5 million, and a whole host of service providers who provide these services. This is a very, very difficult universe to track. We have learned that within this benefit plan universe there are certain kinds of criminal offenses that predominate such as economic extortion, kickbacks, embezzlement, and fraudulent, deceptive reporting.

Let me be emphatic. These are not fiduciary violations. They are not technical violations. They are not accidental violations. These are purposeful, willful, malicious acts of fraud. What is more important——

Chairman PICKLE. Are you talking, Mr. Maria, about cases that have actually been tried and evidence produced, or is this just an assumption that you are making?

Mr. MARIA. I am talking about cases tried, evidence produced. We have compelling and abundant evidence that these are the kinds of violations that do occur. Let me qualify this particular point. I am not painting the entire industry as black, but given the vulnerabilities, given those odds, and given the convictions we have obtained and the conclusions that we have arrived at, we can clearly see that there is, on a relative basis, a small group of people who indeed are professional criminals who have no reservations about lying, cheating, and stealing.

This is very important. They may be small in number, but they have a destructive capability disproportionate to their numbers. I don't think we should lose sight of that. We have also learned that these acts of extortion, embezzlement, and kickbacks are not restricted to just union-affiliated plans.

There is a misperception that these things only occur in union affiliated plans, plans that are managed by the Teamsters or the Laborers or indeed, plans that may have some affiliation with some group of southern Mediterranean people. The Teamsters and the organized crime element do not have a monopoly on corruption.

We see these violations occurring with increasing frequency in nonunion plans, indeed in public sector plans and in plans with no union involvement at all.

Chairman PICKLE. Well, Mr. Maria, those are startling statements. Can you give this committee names, addresses of plans and individuals involved, not just the southern Mediterranean influence group, but in these small plans, can you give us some specific information of how to proceed?

Mr. MARIA. yes, Mr. Chairman. There is historical information of cases closed and I am confident there is probably a vehicle by which we can generally describe some of the pending investigations. I would be hesitant to identify some of those plans that are under present criminal investigation.

Chairman PICKLE. Well, I can understand why you would be hesitant, but I am not hesitant in asking you specifically for some of this information so that we might do something about it. I noticed in an article, I think it was in last month's Reader's Digest, in which they talk about racketeering in the pension fund, the journalist or whoever wrote that article, did he counsel with you?

Are you familiar with that article?

Mr. MARIA. Yes, I am.

Chairman PICKLE. Well, now that is a rather strong statement of factual cases. Can you give us other information like that?

Mr. MARIA. I believe we can work with staff and respond to your question very specifically.

Chairman PICKLE. We would like to have that information because, if this is going on, and you said there is an element out there, then we ought to try to ferret them out and do something about it, if we can. So give us what information you can.

Mr. MARIA. We will be happy to, Mr. Chairman. Realizing that this type of corruption wasn't restricted to just the teamsters or indeed organized crime groups, but as I have often said, what we call a new generation of racketeers: attorneys, accountants, bankers, benefit plan administrators, portfolio managers, doctors, and dentists, who by virtue of their acts should be treated just as any organized crime figure or any Teamster if, in fact, they engage in malicious benefit plan fraud. We need punishment which are commensurate with the crime.

We need to demonstrate to people that if you commit criminal acts, willful criminal acts in an area where the results of your acts produce broken dreams and promises, then you need to be held to a high standard. We need punishment commensurate with the crime.

Chairman PICKLE. All right. We need the information for those type of people, the high-paid professionals. Are you saying that neither PWBA nor the IRS goes after that information and audits these kind of returns to get that information, or do you say that we are just lax in that field?

Mr. MARIA. Let me put it this way. You saw a chart here with a target. The people I am talking about aren't on that target or on that radar screen that I have heard so much about. Remember my earlier comments, not one of our criminal convictions was ever spawned by anything contained in the form 5500.

These criminal convictions come as a result of a diagnostic effort by a Federal law enforcement agency, people who are trained, people who are professional skeptics, indeed cynics. They know where to look and how to look.

Being a Federal criminal investigator, Mr. Chairman, is not a self-ordained profession. There are educational requirements. There are indeed training requirements. I would like to elaborate upon those later in my testimony.

Realizing that we had criminal acts in nonunion affiliated plans, even indeed in public sector plans, the inspector general in 1987 directed his Office of Investigations, his second criminal investigative component, to begin to identify and investigate fraud and abuse in nonunion employee benefit plans, to look at such things as reckless endangerment in the workplace. Prior to one of our investigations, nobody ever went to jail for recklessly endangering a worker's life.

Also, we had the Office of Investigations begin to focus on significant material violations of the Federal wage and hour statutes. The important thing here is that I think we must examine the people who are most affected by this kind of fraud. They are not the people from General Motors, not the people from IBM, Ford or Chrysler, not your Fortune 500, indeed your Fortune 100 companies, but they are by and large people working for small to medium-sized companies, companies which don't have big systems of internal control, companies that are indeed vulnerable to fraud and abuse. These are people from the low end of the socioeconomic spectrum, the people who have the greatest expectations of Government protection and thus far we have failed them. With that charge from the inspector general, to pursue these investigations the Office of Investigations within a short period of time obtained 12 convictions: 6 from the Lundberg case about which you heard testimony yesterday, and 6 from other employee benefit plan cases.

The Lundberg case involved $9 million. The other benefit plan cases involved amounts of $750,000, $500,000, $200,000—pocket change to some people. Rather than applaud those accomplishments, in 1988 and the Solicitor of Labor, acting upon the instructions of the Deputy Secretary of Labor, elicited from the Department of Justice an opinion which restricted the investigative jurisdiction of the Office of Inspector General, specifically his Office of Investigations.

This opinion effectively put them out of the business of doing things such as the Lundberg industries fraud investigation. Thus, in one fell swoop, I had my investigative resources, which could be deployed against blatant fraud and corruption in benefit plans cut in half. Legal opinion couldn't have come at a worse time.

Chairman PICKLE. Who cut those funds in half?

Mr. MARIA. Pardon.

Chairman PICKLE. You say those resources were cut in half. How did that happen?

Mr. MARIA. By virtue of the opinion. Opinion from the Department of Justice said the Inspector General's Office of Investigations could investigate only violations involving appropriated funds of the Department of Labor or instances of employee misconduct, so if the investigation didn't involve Department of Labor appropriated funds or perhaps following people around who were stealing erasers and pencils from the Department of Labor, the Office of Investigations is virtually out of business.

Chairman PICKLE. Your investigative work in effect was then cut in half. That is what you are saying?

Mr. MARIA. Correct. These are high-profile areas. These are areas where there are significant vulnerability to fraud and abuse. There is no question about it.

Chairman PICKLE. Well, that is very disturbing.

Mr. MARIA. The opinion couldn't have come at a worse time because what we are facing today is a proliferation of fraudulent self-funded group health plans. Owing to the rapid escalation of health care costs, your insurance companies today don't insure the full spectrum of lives, but only that portion of lives likely to make claims.

Today the insurance companies, your major carriers, have abandoned the small employer market, companies with fewer than 100 employees. They have concluded that that is an unaffordable risk. You now have a vacuum with respect to affordable, legitimate group health coverage for the small examiner in the United States.

The small examiner actually makes up, I think, about one-third of the American workers. We have found, through our criminal investigations, that this vacuum is being exploited by a number of unscrupulous promoters. These are people who form what they purport to be multiple employer welfare arrangements, self-funded trusts, and attempt to sign up groups of small employers, and they do.

It is a very seductively attractive arrangement, with rates at 30 to 40 percent below prevailing market rate, offering to cover you without a physical examination, will cover preexisting conditions, meaning if you have a heart condition or cancer, they will insure you anyway.

The bottom line here is if it appears too good to be true, then it is. The tragedy of it all is that it affects people at the low end of the scale. They think they have insurance. They don't. And they only find out they don't have health insurance when they seek reimbursement.

Worse than that, if they become ill during this period when they think they are covered, they then develop in the terms of the trade a "preexisting condition" if there are no other insurance companies who will insure them at affordable rates for something that was developed such as cancer or spinal conditions.

Chairman PICKLE. We have a vote on. We have to recess the committee. Do you want to make a summary at this point or would you prefer that we come back so you can resume?

Mr. MARIA. Mr. Chairman, if you will indulge me, I would prefer that we come back. This is a serious problem.

Chairman PICKLE. We will recess, then, for 10 minutes and be back.

[Recess.]

Chairman PICKLE. I would ask that the subcommittee come to order again. Mr. Maria, if you will proceed.

Mr. MARIA. Thank you, Mr. Chairman. Just a few additional words about these fraudulent self-funded group health plans.

The consequences of this type of fraud are devastating to people who thought they had insurance and then once encumbered with an illness or victim of an accident they find they have none. They then become personally liable for their medical bills and then again they may very well develop a malady for which they will never be insured in the future.

Historically, the States through various State insurance bodies have been attempting to pursue this type of fraud with a civil approach, and what they have learned is that after approximately 8 years the civil approach has been very infective. It has been costly. It has been lengthy. For the most part, in dealing with professional criminals that we have here, fraud artists, they obtain a judgment, and the judgment remains uncollected.

Today in the State of Texas alone, there are $19 million in uncollected judgments against fraud artists involved in these self-funded group health plans. What the States have learned is that these are multistate schemes where the assets are dissipated. The premium revenue is dissipated from day one, leaves the State of Texas, for example, and goes to adjoining States, as do the perpetrators of these schemes.

Clearly, a Federal enforcement process is needed. Multistate fraud schemes require a Federal enforcement effort. I can tell you this, thus far there has been one successful prosecution in Fort Worth. It was an investigation conducted by the U.S Postal Service and the State board of insurance. The defendant was Bobby Browning. At the time the investigation started, Bobby Browning had left participants with some $4 million in unpaid claims.

As a result of the efforts of the State board of insurance and the U.S. Postal Service, it was about the first indictment and conviction in recent years, indictment and conviction.

Bobbie Browning was taking approximately $100,000 a month out of the fund for personal salary and lavish expenses, leaving no money to be paid for claims.

Chairman PICKLE. What was the plan?

Mr. MARIA. It was the Christian Organization's Medical Society. He was offering health insurance, marketed as insurance. It was really a self-funded trust. He was offering group health coverage to people who worked for churches in States throughout the United States.

Bobby Browning was convicted and recently sentenced to 15 years in jail. The efforts of the Inspector General's Office of Labor Racketeering, in conjunction with the FBI and the Georgia Bureau of Investigation, have resulted in an indictment returned in January in Atlanta charging four individuals and two corporations with embezzlements and kickbacks for running a self-funded group health insurance.

One of the individuals is now a fugitive in Europe. This is a trust that had as its participants nearly 9,000 employees from 300 corporations doing business in 16 States. You can clearly see that one individual State doesn't have the ability to address this type of fraud.

The third point or the third factor leading to what we consider to be a vulnerability in the employee benefit plan universe involves a fragmented enforcement process with in the Department of Labor. In addition to the Office of Inspector General and the Pension Welfare Benefits Administration, the Pension Benefit Guarantee Corporation and indeed the Wage and Hour Division in the Department of Labor, all gather data and information which impact upon employee benefit plans.

It is difficult, however, for the Office of Inspector General to share information about pending criminal investigations. In addition to Federal grand jury instructions, the premature disclosure of investigative material could jeopardize criminal investigative objectives.

We heard Congressman Anthony speak yesterday of the possibility and indeed the feasibility of conducting two track investigations, conducting both a civil and criminal investigation.

They are possible, and in certain situations, depending on the facts and circumstances, perhaps both methods of redress should be employed: but a word of caution. The considerations regarding jeopardizing a criminal investigation are not present with respect to sharing information related to civil investigations.

The information conducted in a criminal investigation, the mere presence of a criminal investigation, will not thwart a civil investigation. There is a balance to be achieved, and it can be achieved very logically through one person. That person is the U.S. attorney.

The U.S. attorney should, in fact, be the one individual who coordinates and indeed directs a criminal investigation and a civil investigation. He, alone, can determine and assure that the civil investigation does not compromise legitimate criminal investigative objectives.

Now, it has been represented here in previous testimony that the Pension Welfare Benefits Administration and the Office of Inspector General do coordinate, do cooperate, and do exchange information. Don't believe it.

The Pension Welfare Benefits Administration, in its existing memorandum of understanding with the Office of Inspector General, is supposed to provide information regarding any examination of the undertakings of a number of unions, union affiliated plans that have been defined by the Office of Inspector General.

As a practical matter, we receive only a print out of cases closed, we receive no information of when those cases are opened and indeed what spawned the inquiry.

Was it a random sampling? Indeed, did they have specific information? They have been unwilling to modify the existing agreement in order to achieve the coordination objective, which I outlined earlier; namely, allowing a U.S. attorney to control the direction and conduct of parallel investigations.

With the exception of those investigations involving sensitive techniques, such as electronic surveillance, wire taps, or undercover operations, I am prepared today to share with them every open case we have in the area of employee benefit plans so that we can explore the feasibility of joint efforts, leveraging our resources, indeed pursuing civil redress along with criminal redress, but with the stipulation that that be coordinated by the U.S. attorney.

With respect to the Wage and Hour Division in conducting investigations of violations of Davis-Bacon Act frequently finds significant material violations, situations in the construction industry and heavily unionized areas of the country where not only is there a failure to pay the hourly scale, but there is a failure to make requisite pension and welfare plan contributions.

Mr. Chairman, quite simply, that is a red flag. That is something that should not logically happen in the construction trades in major areas of the country such as Philadelphia, New York, and Chicago.

That is a suggestion of some quid pro quo between management and labor: somebody has sold somebody out. We should know about it. By merely addressing the failure to pay the prevailing scale, you are treating the symptom, not the cause.

Now, an analysis to determine what caused savings and loan institutions to fail could probably be useful to those institutions right now charged with supervising the S&L bailout.

I say that, similarly, an analysis and sharing of information as to why an employee benefit plan has failed and indeed come under the aegis of the Pension Benefit Guarantee Corporation could be useful to ERISA enforcement agencies, specifically to the Office of Inspector General.

What caused the bankruptcy, what caused the insolvency? Did a plan fail because of poor business judgment, unforeseen economic events, exuberant entrepreneurial undertakings, an act of God, or were there fraudulent activities by individuals associated with the plan? My question is, what kind of analysis of that nature is being made today.

Now, finally, to probably the most contentious issue: the fraud enforcement strategy. We have said that with respect to employee benefit plans there has been an inordinate reliance on civil remedies. Indeed, if you will look at the statistics of the Pension Welfare Benefits Administration, its budget submissions over the last year, less than 2 percent of their investigative effort has been categorized as criminal investigations.

That is less than 2 percent. They talked about in the last year of achieving 11 indictments. Bearing in mind an indictment is only a charge, I didn't hear anything about convictions. Remember, given the vulnerabilities, given what we have learned historically with 300 some convictions in the Office of Labor Racketeering, indeed the 12 convictions obtained in a very short period of time for Office of Investigations, there are rascals, there are pirates, there are criminals out there.

How effective is our mechanism for identifying them and pursuing them? In response to our recommendation that there needs to be an increased reliance on criminal investigations and criminal remedies, not suggesting that they are panacea, but a greater number of them need to be factored into the enforcement equation, the Pension Welfare Benefits Administration, indeed the Secretary of Labor, has chosen to ignore the Office of Inspector General.

We have in the Office of Investigations approximately 100 special agents, trained Federal criminal investigators, who could be deployed in this area. The Assistant Secretary for the Pension Welfare Benefits Administration speaks about his coordination with other law enforcement agencies, indeed with the FBI, indeed with the U.S. attorney.

My question is, if you have the in-house resource and we are in a diminishing budget environment—these are people who are specially trained, recognized by the Office of Personnel Management as Federal criminal investigators, only——

Chairman PICKLE. Are you saying that your office is not being brought into these cases and is not being asked to participate?

Mr. MARIA. Because of that opinion from the Department of Justice, which was elicited by the former Secretary of Labor and which this present Secretary of Labor endorses, they are not referring to the inspector general employee benefit plan abuse cases.

Chairman PICKLE. Well, when that Justice Department case was issued, or decision was issued, how many cases were you actually participating in from a criminal standpoint at that time?

Mr. MARIA. In terms of employee benefit plans?

Chairman PICKLE. Yes.

Mr. MARIA. Well, the Office of labor Racketeering is not affected by that opinion, but the Office of Investigations was, there were approximately eight employee benefit plan corruptions cases.

Chairman PICKLE. Well, now if you had only eight cases actually underway, how would that cut your work in half?

Mr. MARIA. Perhaps I misspoke. I meant to say that what that opinion did is cut in half the number of people that I could assign to do other employee benefit plan cases.

Chairman PICKLE. That makes a difference.

Mr. MARIA. The response has been, rather than take advantage of two investigative offices that we have—the only special agents, indeed the only federally trained and recognized criminal investigators in the Department of Labor are in the Office of Inspector General—how can you say it is good government if you don't use them? They are specially trained.

Chairman PICKLE. You are saying they are not using your office to the extent they should?

Mr. MARIA. To the extent they should, yes, I maintain that. Does it make sense? Now, if they are really serious, if they really recognize that there are professional criminals, and that is what we are dealing with here, not crimes of ignorance, not accidental crimes, but purposeful and malicious crimes—being a Federal criminal investigator is not a self-ordained occupation.

The Assistant Secretary testified before that they are heightening their criminal awareness. Indeed, they attend a 3-week white collar crime session at the Federal law enforcement training session at Glynco. How many did? Good question.

And they are going to hold a 1 week criminal training session in Boulder, Colo., with the U.S. attorney, the FBI, and the Department of Justice. Let me ask you this. Will that make you, in the eyes of the Office of Personnel Management, will that make you a trained Federal criminal investigator?

Will they pin that badge on you? The answer is categorically, no.

Chairman PICKLE. Well, we could say it would help, and they should be holding it, but that sure does not make a fully qualified inspector, I would agree with that.

Mr. **Maria**. It will help, it will help, I think, to sensitize them to the fact that there is fraud, and if the facts and circumstances suggest fraud and corruption, then it should be referred to those who know where to look and how to look and are recognized by the Government as having that capability.

Chairman **Pickle**. All right, now, Mr. Maria——

Mr. **Maria**. Mr. Chairman, one more point, and it is a telling point.

Chairman **Pickle**. All right. Go right ahead.

Mr. **Maria**. The Assistant Secretary has testified that they start investigations. They don't know whether they are going to be civil or criminal. That is a road map to self-defeat. Any criminal investigator with any degree of competence and experience realizes when he receives allegations and he has facts at his disposal, he should be able to discern whether or not we have willful fraud and corruption, and in making that decision, one of his first steps is to visit and sit down with the U.S. attorney to get a prosecutorial opinion.

That is very critical to the criminal investigative process to determine if the case has prosecutive merit and, indeed to allow the U.S. attorney to become part of that investigation, because you need his help in terms of grand jury subpoenas. You need his help if you want to wire tap or an affidavit for a search warrant. That is critical.

Now, to say they open an investigation and allow the facts to take them some place, they don't know where they are going. This is unstructured, unplanned, and it doesn't have any discernible objectives. You can't conduct investigations that way if you are really serious about detecting professional criminal activity.

To me it smacks a lot of what I read in Alice in Wonderland, if you will indulge me. The Cheshire cat asked Alice where she wanted to get to. Alice said she didn't much care where, and the cat said, "It doesn't matter which way you go. Any road will take you somewhere if only you walk long enough."

I submit to you, pension and welfare plan participants, the Congress, and indeed the taxpayers can ill-afford something which is wandering aimlessly.

That approach is doomed to failure. It will not address purposeful malicious criminal acts.

[The statement of Mr. Maria follows:]

STATEMENT OF RAYMOND MARIA
DEPUTY INSPECTOR GENERAL
U.S. DEPARTMENT OF LABOR
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

JUNE 13, 1990

Mr. Chairman and Members of the Subcommittee,

I am pleased to appear before you this morning to discuss the administration and enforcement of the Employee Retirement Income Security Act of 1974 (ERISA). This is the eighth time I have appeared before a Congressional committee since last August to discuss this topic. I firmly believe that each one of these appearances has been worthwhile because the findings and recommendations of the Office of Inspector General (OIG) concerning ERISA enforcement are relevant, timely, and supported by fact.

Fourteen months ago OIG sounded an alarm regarding the vulnerability of this nation's private pension and welfare plans to fraud and abuse, and the inadequacies of the Federal enforcement effort with respect to these plans. Since that time, we have seen only limited improvement in this effort, and systematic enforcement inadequacies remain largely unaddressed.

Four basic factors contribute to the vulnerability of these benefit plans:

-- The overwhelming number of plans and the limited resources of the Federal Government devoted to the oversight and investigation of them;

-- The Department of Labor's (DOL) inability to use the Independent Public Accountant (IPA) reports required by ERISA as effectively as possible;

-- The Federal Government's fragmented enforcement structure, and;

-- The flawed enforcement strategy of the Department of Labor.

During my testimony this morning I would like to develop each of these points. I will also describe OIG's benefit plan enforcement strategy and, in doing so, supply the basis for some of my remarks this morning.

The Benefit Plan Universe

The testimony submitted today by the DOL Assistant Secretary for Pension and Welfare Benefits indicates there are presently over 900,000 private pension plans, with over $2 trillion in assets, and over 4.5 million private welfare plans, which hold another $25 billion. At the same time, Assistant Secretary Ball states that the Pension and Welfare Benefits Administration (PWBA), which has the primary responsibility for enforcing ERISA, has a staff of approximately 300 in its Office of Enforcement.

As a result of this wide discrepancy between the resources of PWBA and the number of benefit plans, fewer than one per cent of all ERISA-covered benefit plans receive even passing scrutiny each year by PWBA. Certainly, these are very appealing, even inviting, odds for those who would consider embezzling or corrupting a benefit plan. It is crucial not only that PWBA employ its limited resources in such a fashion as to obtain the best return possible, but it is also crucial that other Federal Government agencies and offices be employed for assistance and expertise when possible.

OIG Benefit Plan Enforcement

Although PWBA has the primary responsibility for administering ERISA and enforcing its provisions, both civilly and criminally, OIG's Office of Labor Racketeering (OLR), pursuant to the authority granted in the Inspector General Act of 1978, has conducted criminal fraud investigations related to employee benefit plans since its inception in 1978. Through the end of May, OLR has obtained the indictments of 392 individuals and the convictions of 315 individuals who have defrauded pension and welfare plans.

Over 90% of OLR's benefit plan investigations encompass potential criminal violations involving welfare plans which provide, or purport to provide, medical, dental, optical, legal assistance, alcohol/drug rehabilitation, and related services. These welfare plans are much more vulnerable to fraud and corruption than pension plans due to their extremely large number; the structure of these plans, which generally include various layers of administration and a fairly constant cash flow in and out of the plans, and; the large number of service providers. Further, the great majority of OLR's investigations have involved collectively bargained, union-affiliated benefit plans.

In conducting these investigations we have learned that certain kinds of criminal offenses predominate: economic extortion, kickbacks, embezzlement, and fraudulent or deceptive reporting. These are not technical violations of ERISA's reporting, disclosure, or fiduciary requirements. These are serious criminal acts.

We have also learned that these offenses occur in five different areas of benefit plan operations: benefit payments, administrative costs, investments, sponsor contributions, and service providers.

Perhaps what is most important is that we have learned that these criminal acts are not confined to union-affiliated plans. They are also present in non-union single employer benefit plans. Accordingly, in 1987 OIG decided to utilize the resources of its second criminal investigative component, the Office of Investigations (OI), to investigate fraud and corruption in single employer plans.

This effort led not only to several successful prosecutions but also to a March, 1989 Department of Justice legal opinion, requested by DOL, which restricts the investigative authority of all Inspectors General and precludes OI from conducting any additional single employer benefit plan investigations.

Fraudulent Self-Funded Group Health Plans

This legal opinion could not have come at a worse time due to the recent proliferation of fraudulent self-funded group health plans, also known as multiple employer welfare arrangements, or "MEWAs."

Owing to the rapid escalation of health care cost, major insurance companies today only insure that portion of the population which is least likely to submit claims. The carriers have concluded that the small company (fewer than 100 employees) represents an unacceptable risk for group health insurance and have abandoned the small employer market.

The vacuum created by the major carriers' departure is being filled rapidly by MEWAs. Criminal investigations conducted by OLR have disclosed that a significant number of self-funded MEWAs are fraudulent schemes which create tragic consequences for subscribing employers and participants by leaving them liable for unpaid medical bills and creating "pre-existing" conditions for which they will never be insured in the future.

These fraudulent self-funded MEWAs offer premiums well below the prevailing market rate for legitimate trusts and insurance companies and do so without any intention to meet their total reimbursement liabilities. With the expectation of staying afloat for a period of time through aggressive selling and slow claims payment, these fraudulent MEWAs have become a variation of the classic criminal Ponzi scheme.

We cannot yet accurately determine the extent of this problem or the number of fraudulent MEWAs in operation. However, 34 States attended a recent conference on this subject sponsored by OLR and the United States Attorney in Atlanta. As a specific example, the Texas State Board of Insurance has stated that thousands of MEWA plan participants have been left with unpaid medical bills since 1982, over $19 million in known unpaid claims has been established, and unpaid claims not yet reported are estimated to total at least this much.

State insurance regulators have been largely frustrated in their attempts to address this problem. Unlike legitimate insurance carriers, self-funded MEWAs are not generally licensed by State regulatory offices and fraudulent MEWAs do not maintain reserves for the payment of future claims. Purported stop-loss or reinsurance coverage is often non-existent or merely another part of the overall fraudulent scheme. In some instances, the reinsurer is nothing more than an off-shore shell company.

When State insurance officials attempt to investigate and regulate these plans, they often encounter preemption claims under ERISA. Even though these claims are invariably meritless, State officials often require DOL assistance to demonstrate this fact. The State officials to whom we have spoken have criticized the lack of assistance they have received from DOL, although I would note that PWBA recently instituted a multi-part program designed to provide MEWA-related technical assistance to State officials.

While this program is potentially helpful, State officials increasingly have emphasized that civil litigation concerning MEWAs is ineffective and expensive. While State action is pending, MEWAs continue to collect premiums and avoid payment of employee medical claims. Even if a State ultimately prevails, civil judgments cannot be collected as the MEWAs claim bankruptcy or earlier have dissipated any assets and premium revenues. In most cases, the unscrupulous operators then proceed to institute new MEWA schemes, perhaps changing only names and/or locations. Aggressive criminal enforcement is necessary in order to deter this sort of professional criminal conduct and to protect plan participants and beneficiaries.

Although States are not preempted from prosecuting MEWAs criminally, they are often prevented from doing so because many fraudulent MEWAs are multi-state schemes, and individual States cannot adequately investigate such schemes nor obtain physical jurisdiction over persons and assets.

Within the last year, OIG has begun to use its Office of Labor Racketeering jurisdiction to open over two dozen criminal investigations involving MEWAs. In January, a joint investigation involving OLR and other Federal and State law enforcement agencies resulted in a federal indictment in Atlanta charging four individuals and two corporations with embezzlement and with making and receiving kickbacks in connection with the operation of a fraudulent MEWA. This MEWA purported to provide health benefits to approximately 9,000 employees and dependents of nearly 300 companies located in 16 states. This scheme left participants with approximately $1 million in unpaid claims. OIG expects similar indictments in the near future.

Mr. Chairman, I am certain that you are aware of this problem because the Texas State Board of Insurance has been inundated with complaints, as your office may be. OLR has several active investigations in Texas. Even more could be done with regard to fraudulent MEWAs, both in Texas and around the nation, if OIG Office of Investigations resources were available.

ERISA Self-Policing -- The Role of Independent Public Accountants

One part of the ERISA enforcement effort involves self-policing by benefit plans, and a crucial component of this effort is the Independent Public Accountant (IPA) reports.

ERISA requires annual audits by IPAs for all employee benefit plans with more than 100 participants. ERISA's protections for plan participants depend heavily upon a thorough and responsible job by the IPAs in examining plan transactions and attesting to the validity of plan financial statements.

Since 1984, OIG's Office of Audit has performed extensive work regarding the quality and use of IPA audit reports. We have consistently found that IPA audit work is inadequate in scope and substandard in quality, and that PWBA has not used the IPA resource effectively. Specifically, we have found:

- Current "limited scope" audits do not adequately test transactions or plan assets. ERISA allows a plan administrator to omit from audit review any assets held in trust in a government-regulated industry such as a bank or savings and loan institution. However, OIG audit work has disclosed that audits of these government-regulated institutions are sporadic at best, precluding a continuous verification of plan assets or continuous assurance that these assets are being managed in compliance with ERISA. The American Institute of Certified Public Accountants (AICPA) and the DOL support our recommendation for the elimination of the ERISA provision allowing limited scope audits, and legislation has been introduced in the Senate (S. 2012) which would accomplish this objective.

- The AICPA Industry Audit Guide for Audits of Employee Benefit Plans, originally published in February 1983, has become seriously obsolete. Although the accounting profession has recently sought to close the "expectation gap" between what clients and the public expect from audits and what the profession delivers, the AICPA has yet to integrate their many new Statements on Auditing Standards (SASs) into the AICPA audit guide for the benefit plan industry. It was expected that the AICPA's revision of this guide would incorporate significant additional procedures to ensure that the financial audit required by ERISA would achieve its statutory intent. However, the initial drafts of the new guide did not accomplish this objective, and months of negotiations with the AICPA resulted in a stalemate. In April, senior officials of the AICPA's Auditing Standards Board agreed that the draft revisions were not adequate and made a commitment to work with DOL regarding this issue. OIG is hopeful that this commitment will result in a new guide which provides the greatest possible degree of protection to plan participants.

-- IPA audits do not consistently meet professional standards and PWBA is not enforcing existing ERISA requirements that these standards be met. For example, required schedules of matters such as transactions with parties-in-interest, assets held for investment, and reportable transactions are often not included in IPA reports. Consequently, plan participants are not receiving the information or protections of full disclosure as Congress intended. OIG commends the Department of Labor's recommendation that ERISA be amended to require IPAs to undergo a peer review every three years. In the meantime, OIG would like to see PWBA use its existing authority against plan administrators to obtain corrective action on IPA work that fails to meet professional standards.

-- IPA audits are not disclosing information to plan participants or rendering opinions on information accompanying a plan's financial statement as required by ERISA. Under current IPA reporting procedures, neither the Department nor the participants are directly informed of potential ERISA violations. IPAs consider plan sponsors or administrators to be their clients, and their reports are addressed to these parties. Congress and/or PWBA should require direct reporting by IPAs of potential and actual ERISA violations to senior plan management, the board of directors or its audit committee, and PWBA.

Fragmented Coordination

In addition to OIG and PWBA, the Pension Benefit Guaranty Corporation (PBGC) and the Internal Revenue Service (IRS) play significant roles in the enforcement of ERISA. Unfortunately, coordination among these groups is fragmented and relevant information is all too often not shared or shared much too late to be of use.

Within DOL, it is difficult for OIG to share information related to pending criminal investigations or to our ongoing intelligence gathering efforts. In addition to Federal grand jury restrictions, the premature disclosure of such information could jeopardize criminal investigative objectives.

However, these considerations generally are not present with regard to the sharing of information related to PWBA's civil investigations and cases, and parallel civil and criminal proceedings can take place, as long as one individual controls them. That individual must be the United States Attorney.

Although OLR and PWBA have a memorandum of understanding which calls for the sharing of certain organized crime related information, PWBA has not always provided such information to OLR. Further, PWBA has been unwilling to modify this agreement in order to achieve the coordination objective which I just mentioned and allow the U.S. Attorney to control the direction and conduct of parallel investigations.

Other DOL program agencies beside PWBA obtain benefit plan related information which could be of use to OIG and/or PWBA. For example, many Wage and Hour Division investigations of potential Davis-Bacon Act violations involve employers not only failing to pay prevailing hourly scale but also failing to make required pension and welfare plan contributions. Sub-scale wage and fringe benefit payments by an employer with a collective bargaining agreement or, even in the absence of an agreement, in areas and industries in traditional union strongholds, often are visible manifestations of labor racketeering maladies. Such circumstances should be subjected to prompt investigative scrutiny by OLR.

Although OIG has a memorandum of understanding with the Wage and Hour Division which requires an exchange of information, this system relies upon voluntary referral rather than a more formal, structured mechanism, and Wage and Hour compliance personnel may not always recognize the potential criminal ramifications of certain information and fact patterns.

Analyses to determine what caused individual savings and loans institutions to fail may be useful to the agencies which now preside over the S & L bailout. Similarly, an analysis and sharing of information as to why an employee benefit plan has failed, perhaps by the PGBC, could be useful to ERISA enforcement agencies.

Did a plan fail due to poor business judgment? To entreprenurial exuberance? To an Act of God? Or to fraudulent activities by individuals associated with the plan? If it is the latter, is this information being referred to OIG or to other law enforcement entities for intelligence purposes or specific case-related purposes?

DOL's Flawed Enforcement Strategy: Civil vs. Criminal Remedies

During the past five years, through fiscal year 1989, PWBA has processed over 8,000 field investigations. Fewer than two per cent have been criminal investigations. This continued reliance on civil and administrative remedies and PWBA's limited use of criminal remedies will simply not deter significant benefit plan fraud and corruption.

In theory, I agree with Assistant Secretary Ball's statement that different sanctions are suited for different situations. However, in practice PWBA has shown a strong predisposition to apply civil sanctions regardless of the factual situation presented to them and they have evidenced an inability to recognize fact patterns which cry out for criminal investigation and penalties.

Civil restitution and penalties are a cost of doing business and a way of business for unscrupulous benefit plan operators, administrators, service providers, and others. The criminal sanctions of imprisonment, forfeiture of assets, and disqualification must be judiciously factored into the overall enforcement equation in order to deter criminal activity.

These criminal sanctions are important sanctions and they are routinely applied by OIG's Office of Labor Racketeering. They must be applied with greater frequency to address those offenses which are not technical nor accidental. We are dealing more and more with professional and often sophisticated criminals who defraud and corrupt benefit plans, and especially health plans, for a living. PWBA historically has failed to deal with these types of professional racketeers, and this lack of emphasis must change in order to deter significant wrongdoing and protect plan participants and beneficiaries.

Under the new Federal sentencing guidelines, those who commit economic and financial crimes face a real possibility of jail, rather than probation or similar sentences, because the sentencing guidelines classify these crimes as "serious." The guidelines establish a number of factors which are relevant with respect to benefit plan fraud, including the amount of money embezzled, the number of victims, whether the defendant is a fiduciary with discretion over plan transactions, and whether foreign bank accounts or transactions are used to conceal the fraud.

Further, criminal penalties which include forfeiture of assets avoid arguments and negotiations about appropriate civil restitution and, under the current disqualification provision (29 U.S.C. 1111), an individual can be barred from holding any benefit plan related position for thirteen years.

Congress indicated its interest in the disqualification provision in 1984 when it increased the barrable period from five years to thirteen years, increased the number of barrable offenses, and made the bar applicable upon conviction rather than appeal. In 1988, an OIG investigation produced the only criminal conviction of an individual for holding a prohibited position, which is punishable by a sentence of five years imprisonment and a $10,000 fine.

PWBA has no mechanism for enforcing the disqualification law and no mechanism for tracking individuals who may be subject to its provisions. In the near future, OIG intends to make recommendations regarding a DOL-wide system to identify such individuals.

Congressional Intent

Last year the ERISA Advisory Council, a statutory entity which makes recommendations to the Secretary of Labor, stated its belief that the ERISA statute itself is primarily a "civil" statute. This belief, which translates into penalties limited for the most part to restitution and promises not to repeat the prohibited conduct, distorts the overall intent of Congress.

Regardless of one's characterization of the ERISA statute, there is no support whatsoever for the proposition that individuals associated with employee benefit plans should not be subject to criminal investigation and remedies. Nothing could be further from the truth.

In addition to the criminal provisions which are specifcally included in the ERISA statute, Congress signaled its intent in this area when it enacted 18 U.S.C. 664, which prohibits theft or embezzlement from an ERISA-covered plan; 18 U.S.C. 1954, which prohibits kickbacks and bribes to influence the operations of an employee benefit plan, and; 18 U.S.C. 1027, which prohibits false statements in relation to documents required under ERISA.

Further, Congress has enacted a variety of fraud-related criminal statutes which are applicable to all individuals and situations, whether related to benefit plans or not, such as 18 U.S.C. 1341, the mail fraud statute, 18 U.S.C. 1343, the wire fraud statute, and 18 U.S.C. 371, which prohibits conspiracies to defraud the United States.

In 1984, Congress re-emphasized its desire for vigorous benefit plan criminal enforcement by expressly giving the Secretary of Labor the responsibility and authority to investigate ERISA-related violations. A letter written to the Department of Justice by six of the chief Senate sponsors of this amendment stated:

> Our intent .... was to clearly authorize and encourage an aggressive investigative effort by the Labor Department against corruption and criminal activity in all areas of labor-management relations including, but not limited to, both union and employee benefit plan activity.

Despite this clear and consistent Congressional direction, PWBA has continued to emphasize civil remedies.

PWBA's Limitations

Even if PWBA wished to change its civil emphasis, it does not have any professionally trained and recognized ("GS-1811") criminal investigators, people who know where to look and how to look for criminal activity, people who are adept at using standard investigative techniques such as electronic surveillance, search warrants, undercover operations, and the development of informants and other confidential sources.

These are techniques which are used on a regular basis by OIG investigators. Further, OIG plans to use other recently authorized techniques in its investigations of benefit plan fraud, for example:

-- The execution of searches and the seizure of property and assets pursuant to Federal money laundering statutes (18 U.S.C. 981, 1956), and;

-- The securing of injunctions against fraudulent plan operators and/or the imposition of trustees pursuant to 18 U.S.C. 1345, pending completion of criminal proceedings.

These procedures are particularly relevant in the context of PWBA's seemingly overriding concern that criminal investigations jeopardize the recovery of plan assets. Through the criminal investigation, assets can be frozen and/or seized at an early stage and are therefore still available for recovery in concurrent or subsequent civil proceedings.

Assistant Secretary Ball has extolled PWBA's improved "targeted" enforcement strategy, which relies heavily upon a review of 5500 Forms to obtain investigative leads, but I can assure this Subcommittee that significant benefit plan fraud will not be detected through a review of 5500 Forms, no matter how automated or sophisticated that review is. In general, professional thieves do not file truthful reporting and disclosure forms. None of the convictions arising from an OIG investigation have been spawned by anything contained on a 5500 Form.

Assistant Secretary Ball has also stated on numerous occasions that PWBA does not begin with a civil investigation or a criminal investigation; they begin with generic investigations and see where the facts lead before making any decisions regarding civil or criminal routes. This policy is self-defeating. If we are talking about blatant criminal acts, an investigative strategy must evolve from day one in order to secure necessary evidence and use appropriate investigative techniques.

In short, a strategy which relies upon civil redress, delayed investigative decisions, and a staff which has no professional criminal investigators, is inherently incapable of recognizing flagrant fact patterns, conceptualizing all potential criminal offenses, and addressing serious criminal fraud.

I would note that additional staff positions are being specifically budgeted for ERISA enforcement, both for investigators and for attorneys. OIG commends this decision, but with reservations. This staff increase must be accompanied by a commitment that these resources will be used effectively and efficiently, and will be used to increase the quantity and quality of criminal investigations. This commitment has not been forthcoming.

Conclusion

In concluding my testimony, I would like to respond to one of the questions posed in Chairman Pickle's invitation letter. The Chairman states that the Subcommittee is particularly interested in the likely effect on the employee benefit system if DOL were to place increased reliance on criminal sanctions.

An increased use of criminal sanctions will deter fraudulent schemes and thus provide greater protections to benefit plan participants and beneficiaries. As I stated earlier, civil fines and restitution are all too often merely a cost of doing business. The spectre of imprisonment, forfeiture, and disqualification will have a much greater effect on the administrators, service providers, accountants, attorneys, and other white collar individuals who are ripping off pension and welfare plans.

The argument that criminal investigations will make it much more difficult to pursue civil remedies is unsupported and most likely unsupportable. Certainly, individuals who are under criminal investigation may refuse to cooperate with a PWBA civil inquiry for fear of incriminating themselves or for related reasons. But this impediment is clearly outweighed by the advantages of criminal prosecution: deterrence of other fraudulent activities through appropriate sentences; forfeiture of assets, and; the ability to use a criminal conviction, based upon a standard of guilt beyond a reasonable doubt, in a subsequent civil proceeding.

Further, PWBA's concerns about jeopardizing the recovery of plan assets are overstated and reflect an inability to distinguish fiduciary-type violations and reporting and disclosure violations from serious criminal fraud. I have spoken to numerous State insurance officials and I have heard too many horror stories involving benefit plan fraud. In cases involving malicious and intentional criminal activity, there are often no assets to recover. The money is gone, spent on luxury cars, vacations, deposited in offshore bank accounts. The victims of these schemes are not going to get their contributions or their benefits back and knowing this, these victims almost always want to see somebody sent to jail.

Clearly, the employee benefit system, and the American workers who are the beneficiaries of this system, will be better protected if DOL were to place increased reliance on criminal sanctions. The Office of Inspector General is prepared to increase its benefit plan caseload. However, in order to do so, the investigative authority which was taken away from OIG's Office of Investigations by the 1989 Department of Justice legal opinion needs to be restored. Legislation has been introduced in both the Senate (S.2608) and the House (H.R.4617) to accomplish this and I would urge the Members of this Subcommittee to support this legislation.

I would be pleased to answer any questions from the Subcommittee at this time.

Chairman **Pickle**. All right. Now, Mr. Maria, I think I would observe in connection with your Alice in Wonderland comment that I believe that Yogi Berra said, "If you don't know where you are going, you are going to end up somewhere else." Is that what your are saying?

Mr. **Maria**. That is fair.

Chairman **Pickle**. Let me go back now and ask questions of you. I am glad to have your statements, and your strong suggestions, not charges about what is happening out there, and I think this committee must follow through on a lot of these statements that you have made because you have got the willingness and the courage to come here and make statements that we ought to look into. Now——

Mr. **Maria**. Some have characterized it as other than courage, Mr. Chairman, I might add.

Chairman **Pickle**. But it is information we need to know, and whether we like it or not, whatever way you look at it, the question is what are the facts, and that is what we are trying to establish, and that is why we are holding this hearing. I do want to ask two or three questions in the broad sense because I have got two or three other panels we have got to come to. But let me proceed here.

You have indicated that we are sort of out of the woods now with respect to multiemployer plans, that we have got a better handle on it than we used to have. But in the 1989 annual report by the PBGC, they indicate that 25 percent of multiemployer plans are underfunded, and that 2 percent of these plans are less than 50 percent fully funded. You made reference to that fact earlier.

Now, while the percentage of unfunded plans doesn't appear to be large anymore, the unfunded, vested liability of some of these plans is, in fact, very large. For example, the unfunded, vested liability of the Central States Teamsters plan alone is approximately $2 billion, $2 billion.

Now, accordingly these plans have been stigmatized and new employers avoid using them for obvious reasons because the long-term financial stability of these plans is jeopardized. Because of that there is no new blood to replace the employers going out of business. The contribution base is just going to shrink.

That would be a normal process. Yet, ERISA, allows employers to increase benefits, even if the plan faces a large unfunded, vested liability. Now, do you think the law needs to be improved in this area to ensure that all trustees of unfunded plans adhere to certain guidelines in order to fully fund these multiemployer plans as rapidly and as efficiently as possible?

Are you familiar with this general development out there?

Mr. **Maria**. Yes, I am very familiar, and my response to you would be that given the unfunded situations, I clearly view them as a professional skeptic, red flags which need to be monitored very closely.

If you look at people who have been victimized by plan failures and indeed fraud, we have an obligation to make certain that there needs to be consistency with respect to funding, and I would look at each of those unfunded situations very, very closely, and if new rules are required for that, then perhaps that is something the Congress should consider.

Chairman **Pickle**. Yes, at least in view of the fact that the MEPPA approach has been in operation over 10 years, and still you have this unfunded situation, with this much liability.

Now, Mr. Maria, specifically, in some of your statements you made here this morning, you said that the PWBA does not put enough emphasis on criminal prosecution.

Have your offices, that is the inspector general, conducted any statistically valid review of the civil case completed by PWBA to determine how many of those kind of cases have been the subject of criminal investigations?

Have you made a specific review of that?

Mr. **Maria**. I am not certain I understand the question, Mr. Chairman. Are you asking if we have looked at those cases that were pursued civilly to determine if, in fact, they should have been pursued criminally?

Chairman **Pickle**. I want to know how many of those kind of civil cases had been—should have been specifically targeted for criminal investigations also? Do you know how many of them were targeted?

Mr. **Maria**. No, Mr. Chairman. We have not conducted that type of study.

Chairman **Pickle**. Well, can you conduct such a survey? I want it for factual data for my committee. Can you do such a survey?

Mr. **Maria**. Before committing myself to something so broad in scope, I would like to have my audit colleagues work with your staff. I think we can provide you the kind of information you want.

I do have an example, though. It is a telling point in terms of the ability to discern fraud, things that go well over the mark by any conservative standard, things that go well over the mark by any liberal standard.

If I just may, Mr. Chairman, indulge me on this point. This is a press release from the Pension Welfare Benefits Administration, and I instructed that a criminal case be initiated after I read this. It says basically that the Department of labor, the Secretary of Labor, filed a civil suit in Houston, Tex., against an administrator of pension plans—these were defined contribution plans, so the PBGC could not put down a safety net if the assets are gone—against an administrator for making illegal loans totalling more than $1 million from two company pension plans.

The complaint—I quote,

> The complaint alleges conflict of interest by Walberg when he took pension plan money and loans to himself and a business partner. He also is charged with illegally lending money to plan participants and other persons to invest in various businesses in which he had an interest.

As a result of the loans, Walberg allegedly concentrated the plan assets in cattle and investment programs which failed to follow the diversification rules of ERISA. A couple of words strike me here. "He took." I said, well, what does that mean? Then he invested plan assets in cattle. Our early investigations showed that we are not dealing with $1 million, we are dealing with closer to $3 million.

The business partner, in fact, was his mistress. She and he had a cattle-raising operation on their ranch. He diverted money. He created a subterfuge, falsified loan documents, indeed forged loan documents to give the appearance that these were legitimate loans to third parties.

Chairman PICKLE. All right.

Now, Mr. Maria, I don't question the facts in that case; however, I am not familiar with it.

I hear you, and I am glad we have it on the record. But my question to you was has your office conducted any statistically valid review of the civil cases acted on by the PWBA that should have been criminally involved, and you said that you have not conducted such a survey, but that you would like to work with auditors, my committee and auditors in the Department of Labor or to see if we can get evidence of this.

I asked that such a list be put together. Factually I would like to see that, so that is my request to you.

I also want to ask you, has your office conducted or commissioned a statistically valid sampling of pension or welfare benefit plans to determine whether there is a trend towards increasing violations of ERISA?

Have you made a study that there is a trend, of violations of ERISA?

Mr. MARIA. No, we have not.

Chairman PICKLE. Is it possible to put such a study together?

Mr. MARIA. I would like the opportunity to confer with staff first.

Chairman PICKLE. All right. I would hope you do that.

I was going to ask you how many investigators are currently at work at the Office of Investigation, but you told me you have a hundred in your office.

Mr. MARIA. Approximately 100 in the Office of Investigations and about 110 in the Office of Labor and Racketeering.

Chairman PICKLE. All right.

Now, the Office of Investigations has, in the past, conducted criminal investigations of pension and welfare benefit plans. How many criminal investigations involving pension and welfare benefit plans were conducted by this office in the last 5 years? Have you been with them 5 years?

Mr. MARIA. We are speaking about the Office of Investigations now?

Chairman PICKLE. Yes, sir. Yes, sir.

Mr. MARIA. They only began to conduct criminal investigations in 1987 in the area of employee benefit plan corruption. I will supply that number for the record.

Chairman PICKLE. You don't know how many, then?

Mr. MARIA. It will be fewer than 25, and, of course, the convictions are 12.

Chairman PICKLE. Well, if you don't know how many, then, I was going to ask you how many of these cases were referred to the Department of Justice for prosecution, or how many of these did the department accept?

Mr. MARIA. Well——

Chairman PICKLE. Well, based on that question, since you don't know how many were involved, you will have to look that up and try to get me that information.

Mr. MARIA. Yes, sir.

[The following was subsequently received:]

U.S. Department of Labor

Inspector General
Washington, D.C. 20210

OCT 5 1990

Honorable J.J. Pickle
Chairman
Subcommittee on Oversight
House Ways and Means Committee
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I am pleased to provide you with information that you requested during your June 13, 1990, hearing on the enforcement and administration of The Employee Retirement Income Security Act of 1974, at which Raymond Maria, then Acting Inspector General of the Department of Labor, testified.

1. We have had several discussions with our audit and investigative staff regarding a review of those civil cases acted upon by the Pension and Welfare Benefits Administration (PWBA) that should have been pursued criminally. We have been unable to arrive at what we believe to be a cost-effective, statistically valid methodology which would accomplish this objective and be useful to the Subcommittee. We would be willing to meet with your staff to discuss this matter further.

However, we are aware of several cases, in addition to the Lundberg Industries case which was described in some detail during the hearing, that should have been pursued in a criminal fashion in the opinion of current or former federal prosecutors.

For example, in hearings before the House Committee on Government Operations held December 12, 1989, a former First Assistant U.S. Attorney in Philadelphia, Pennsylvania, testified regarding the work product from a PWBA investigation of educational conferences attended by union officers and plan administrators of several union locals in New York City. He stated in his testimony that he believed the matter should have been pursued criminally rather than civilly as handled by PWBA (testimony enclosed).

Another case which PWBA pursued civilly instead of criminally involved the Weiss Brothers Construction Company, in which a joint federal investigation later resulted in the criminal conviction of the company.

The U.S. Attorney in Houston, Texas, has requested that the OIG conduct a criminal investigation in yet another case that apparently had clear evidence of criminal violations, but which PWBA had elected to pursue only civilly.

2. You also requested that we provide information as to the number of criminal investigations involving pension and welfare benefit plans that had been conducted by our Office of Investigations in the last 5 years. As you know, the OIG's Office of Labor Racketeering has been pursuing these cases since its establishment in 1978. Since that time it has achieved more than 300 criminal convictions involving pension and welfare benefit plans. Most of these convictions were made in the last 5 years.

I should note that the Office of Investigations had only begun conducting such investigations in 1987; therefore, only 20 criminal cases involving pension and welfare plans were in the pipeline when the Department of Justice's March 1989 Office of Legal Counsel (OLC) decision was handed down, which precluded our Office of Investigations from continuing to pursue these criminal cases.

As a result of that OLC March 1989 opinion, 7 of the 20 cases were referred to the Department's PWBA. One of the 20 cases was referred to the OIG's Office of Labor Racketeering. Of the remaining 12 cases, 6 had been referred and accepted for prosecution.

I would be pleased to provide you with any additional information you might need.

Sincerely,

Julian W. De La Rosa
Inspector General

Enclosure

Testimony of
Joseph M. Fioravanti, Esq.
Curran, Winning and Fioravanti

GOOD AFTERNOON MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. THANK YOU FOR THE OPPORTUNITY TO TESTIFY BEFORE THE COMMITTEE TODAY. I HAVE A PREPARED STATEMENT, BUT IN THE INTEREST OF BREVITY MAY I ASK THAT IT BE INSERTED IN THE RECORD AND I WILL SUMMARIZE MY TESTIMONY.

I AM JOSEPH M. FIORAVANTI, AN ATTORNEY AND PARTNER IN THE FIRM OF CURRAN, WINNING & FIORAVANTI. I AM A FORMER FIRST ASSISTANT UNITED STATES ATTORNEY IN THE U.S. ATTORNEY'S OFFICE IN PHILADELPHIA, PENNSYLVANIA. I AM NOW IN PRIVATE PRACTICE AND HAVE BEEN SO FOR THE LAST 8 YEARS. WHILE IN THE U.S. ATTORNEY'S OFFICE I PROSECUTED A WIDE RANGE OF VIOLATIONS OF THE UNITED STATES CRIMINAL CODE. BUT I SPECIALIZED IN PROSECUTING CRIMES INVOLVING COMPLEX FACT PATTERNS RELATING TO SCHEMES TO DEFRAUD AND CORRUPT. I ALSO CONDUCTED RACKETEERING INVESTIGATIONS AND SUPERVISED OTHER ATTORNEYS IN THE OFFICE WHO CONDUCTED WHITE COLLAR CRIME AND RACKETEERING INVESTIGATIONS AND PROSECUTIONS. AMONG THOSE CASES WHICH I HANDLED WAS THE PHILADELPHIA ABSCAM RICO PROSECUTIONS OF 3 MEMBERS OF THE PHILADELPHIA CITY COUNCIL, INCLUDING ITS PRESIDENT AND MAJORITY LEADER.

I SHOULD FIRST SAY, MR. CHAIRMAN, MEMBERS OF THE COMMITTEE, THAT THIS CATEGORY OF CRIMINAL ACTIVITY IS THE MOST INSIDIOUS OF CRIMES. IT INCLUDES CRIMINAL CONDUCT DESIGNED TO ESCAPE DETECTION, AND IF DETECTED, TAILORED TO MINIMIZE THE EXPOSURE OF THE CRIMINAL VIOLATOR TO LEGAL SANCTION. THIS CONDUCT IS DIFFICULT TO INVESTIGATE AND DIFFICULT TO PROVE IN A COURT OF LAW. THE INVESTIGATIONS ARE TIME CONSUMING, LABOR INTENSIVE AND EXPENSIVE TO CONDUCT. THEY CALL FOR A HIGH DEGREE OF COMMITMENT, HARD WORK, CREATIVITY AND INGENUITY. HOWEVER, THESE DIFFICULTIES SHOULD NOT BE IMPEDIMENTS TO THE VIGOROUS PURSUIT OF THE EVIDENCE. THE COLLECTION OF EVIDENCE SHOULD LOOK TOWARD AN APPROPRIATE REMEDY IN THE INDIVIDUAL CASE, BUT ALSO IT SHOULD LOOK TOWARD THE LONG RANGE GOAL OF DETERRING OTHERS WHO MIGHT VICTIMIZE THE WEAK, THE POOR, THE VULNERABLE AND THE UNKNOWING.

I HAVE BEEN ASKED BY THE COMMITTEE TO ANALYZE A SERIES OF FACT PATTERNS DEVELOPED BY THE INVESTIGATIVE AND ENFORCEMENT PERSONNEL OF THE PENSION WELFARE BENEFITS ADMINISTRATION OF THE U.S. DEPARTMENT OF LABOR. THIS SERIES OF FACT PATTERNS WAS GENERALLY DESCRIBED TO ME BY A STAFF INVESTIGATOR OF THIS COMMITTEE IN AN ORAL PRESENTATION ACCOMPANIED BY EXTENSIVE DOCUMENTATION WHICH HAS BEEN REPRESENTED TO ME TO BE THE WRITTEN WORK PRODUCT OF THE PENSION WELFARE BENEFITS ADMINISTRATION PERSONNEL.

MY ANALYSIS, OBSERVATIONS AND RECOMMENDATIONS FOLLOW:

OFFICERS AND PLAN ADMINISTRATORS OF LOCAL 23 OF THE MASON TENDERS UNION, THE OPERATING ENGINEERS, LOCAL 94, 94A AND 94B, AND LOCAL 27 OF THE INTERNATIONAL BROTHERHOOD OF TEAMSTERS, ALL OF NEW YORK CITY, HAD BEEN ATTENDING, MULTI-ANNUALLY, SO-CALLED EDUCATIONAL CONFERENCES, BETWEEN 1983 AND 1987, AT LOCATIONS INCLUDING LONDON, ENGLAND; SCOTTSDALE, ARIZONA; ATLANTIC CITY, NEW JERSEY; AND BERMUDA. THE PLAN ADMINISTRATORS, SEVERAL OF WHOM ARE BELIEVED TO BE LA COSA NOSTRA MEMBERS OF THE GAMBINO CRIME FAMILY OF NEW YORK, SPENT TENS OF THOUSANDS OF DOLLARS ENTERTAINING THEMSELVES AND FAMILY MEMBERS AT THE EXPENSE OF UNION MEMBERS, MEMBERS TO WHOM THEY OWED A FIDUCIARY DUTY TO SAFEGUARD THESE SAME FUNDS THEY WERE SPENDING. LITTLE, IF ANY, UNION ACTIVITY WAS INVOLVED.

THE INVESTIGATION OF THESE EXCESSES CAME UNDER THE AUSPICES OF THE PENSION AND WELFARE BENEFITS ADMINISTRATION. THE INVESTIGATION, AS FAR AS IT WENT, WAS COMPETENTLY UNDERTAKEN, BUT POSSIBLY MISCONCEIVED IN ITS ULTIMATE PURPOSE. THE OUTCOME OF THE INVESTIGATION WAS THAT THE ADMINISTRATION SOUGHT RESTITUTION FROM THE PLAN ADMINISTRATORS. THE CULPABLE INDIVIDUALS SUFFERED NO PUNITIVE SANCTIONS, AND NO MESSAGE WAS SENT TO THESE PLAN ADMINISTRATORS, AND OTHERS, THAT THE FEDERAL BUREAUCRACY WOULD DEAL HARSHLY WITH THESE VIOLATIONS OF THE LAW.

AS AN ALTERNATIVE APPROACH, IT IS MY VIEW THAT IT WOULD HAVE BEEN MORE PRUDENT TO SUBMIT THESE TRANSACTIONS TO EXPERIENCED CRIMINAL INVESTIGATORS AND FEDERAL PROSECUTIONS OF THE UNITED STATES ATTORNEY FOR THE SOUTHERN DISTRICT OF NEW YORK. LET ME EXPLAIN WHY:

THE SAME CONDUCT WHICH WAS MADE THE SUBJECT OF CIVIL RESTITUTION, MIGHT JUST AS EASILY HAVE PROVIDED THE BASIS FOR BILLS OF INDICTMENT UNDER EXISTING PROVISIONS OF TITLE 18, THE CRIMES CODE. SPECIFICALLY, SECTIONS 664 AND 1954 PROSCRIBE THE

RECEIPT OF ITEMS OF VALUE BY UNION OFFICIALS IN VIOLATION OF THE FIDUCIARY DUTY OWED TO THE MEMBERSHIP. UPON THE SAME THEORY, A SCHEME TO VIOLATE THE LOYAL AND FAITHFUL SERVICES OBLIGATION OF THOSE UNION OFFICIALS TO THEIR MEMBERSHIPS, BY THE USE OF THE UNITED STATES MAILS OR INTERSTATE TELEPHONE CALLS COULD IMPLICATE THE MAIL AND WIRE FRAUD STATUTES OF SECTIONS 1341 AND 1343. MULTIPLE VIOLATIONS OF THESE PROVISIONS BY AN ENTERPRISE WHOSE ACTIVITIES WERE INVOLVED IN INTERSTATE OR FOREIGN COMMERCE MIGHT JUSTIFY INDICTMENT UNDER THE RICO STATUTES, SECTION 1962. THIS COMMITTEE, AND THE CONGRESS OF THE UNITED STATES, MIGHT WANT TO CONSIDER THE POSSIBILITY OF OTHER CRIMINAL SANCTIONS. WITHOUT CONSIDERATION TO POSSIBLE CRIMINAL PROSECUTION, IF PLAN ADMINISTRATORS FACE NOTHING MORE THAN POSSIBLE RESTITUTION OF THE FUNDS THEY HAVE MISUSED, THERE IS NO EFFECTIVE DETERRENT TO FUTURE VIOLATIONS.

I BELIEVE THAT IF THE RESOURCES OF THE INSPECTOR GENERALS, OFFICE OF LABOR RACKETEERING, THE F.B.I., UNITED STATES POSTAL INSPECTORS AND THE UNITED STATES ATTORNEYS OFFICE OR ORGANIZED CRIME STRIKE FORCE HAD BEEN CONSULTED, CRIMINAL CHARGES MIGHT WELL HAVE RESULTED, AND A REAL IMPACT MADE.

A SIMPLE POLICY OF REFERRAL BY THE PENSION AND WELFARE BENEFITS ADMINISTRATION TO THE UNITED STATES ATTORNEY, GIVING THE U.S. ATTORNEY, IN EFFECT, A RIGHT OF FIRST REFUSAL, MIGHT REAP REAL BENEFITS IN THESE CASES. THE INVESTIGATIVE POSSIBILITIES ARE LIMITLESS. AGENTS OF THE ADMINISTRATION COULD BE TEAMED WITH CRIMINAL INVESTIGATORS OF THE INSPECTOR GENERALS, OFFICE OF LABOR RACKETEERING, THE F.B.I. OR POSTAL INSPECTORS WORKING WITH AN ASSISTANT U.S. ATTORNEY FROM THE EARLIEST STAGES OF THE INVESTIGATION. IT WAS OUR EXPERIENCE IN PHILADELPHIA THAT THE FORMATION OF A PROSECUTOR/INVESTIGATOR TEAM FROM THE OUTSET OF THE INQUIRY RENDERED THE KIND OF EVIDENCE NECESSARY TO PROVE THE ANTICIPATED VIOLATIONS AT TRIAL.

A GRAND JURY WOULD BE CONVENED TO GATHER RECORDS OF RESORT EXPENSES, IDENTITIES OF PARTICIPATING PARTIES IN THE SO-CALLED EDUCATIONAL CONFERENCES AND THE MEANS AND METHODS OF DOCUMENTING THE EXPENSES ON THE UNIONS BOOKS. THE USE OF COMPELLED TESTIMONY OF ONE OR MORE INSIDERS TO THE CONFERENCES, THROUGH THE GRAND JURY AND THE FEDERAL USE IMMUNITY STATUTE, WOULD PROVIDE AN EVIDENTIARY INSIDE LOOK AT THIS CONDUCT. WITNESSES CALLED BEFORE THE GRAND JURY, UNDER OATH, AND BEFORE A COURT REPORTER ARE

COMPELLED TO TESTIFY TRUTHFULLY, UNDER THREAT OF PERJURY PROSECUTION, AND ARE PREVENTED FROM CHANGING OR FORGETTING TESTIMONY LATER NEEDED AT TRIAL. A REFUSAL TO TESTIFY, UNDER A 5TH AMENDMENT RIGHTS ASSERTION, IS AVOIDED BY THE USE IMMUNITY STATUTE, WHERE THE WITNESS IS COMPELLED TO TESTIFY OR FACE INCARCERATION FOR CONTEMPT OF THE DISTRICT COURT'S ORDER COMPELLING THE TESTIMONY OF THE WITNESS BEFORE THE GRAND JURY.

THE USE OF TITLE III NON-CONSENSUAL WIRE INTERCEPTIONS, OR CONVENTIONALLY MONITORED CONVERSATIONS, ARE INVALUABLE INVESTIGATIVE TOOLS PRODUCING STATEMENTS OF SUBJECTS OF THE INVESTIGATION NOT SUBJECT TO CROSS EXAMINATION OR OTHER METHODS OF IMPEACHMENT AT TRIAL. ADD TO THAT THE USE OF VIDEOTAPE, AND THE NUANCES OF FACIAL EXPRESSIONS, GESTURES AND MANNERISMS SPEAK VOLUMES ABOUT THE INTENT OF THE SPEAKER WHO IS MONITORED.

LASTLY, A SUCCESSFUL PROSECUTION, ONCE OBTAINED, SERVES THREE PURPOSES, TWO OF WHICH ARE NOT SERVED BY THE USE OF THE RESTITUTION SYSTEM CURRENTLY EMPLOYED BY THE ADMINISTRATION. THE PROSECUTION PUNISHES THE OFFENDER, SENDS A POWERFUL MESSAGE TO THE COMMUNITY AND THEN, AMONG THE SENTENCING POSSIBILITIES, CAN EASILY PROVIDE FOR THE NECESSARY RESTITUTION.

IN CLOSING, I SHOULD POINT OUT THAT I MAY HAVE HYPOTHETICALLY CONVICTED PEOPLE WHO HAVE NOT VIOLATED THE AFOREMENTIONED SECTIONS OF THE CRIMINAL CODE. IT IS NOT MY ROLE HERE TODAY TO REACH SUCH CONCLUSIONS, AND I AM UNCOMFORTABLE IN PREJUDGING THESE FACTS. HOWEVER, IT IS ABUNDANTLY CLEAR THAT THERE IS THE KIND OF REASONABLE SUSPICION IN THE FACTS I WAS PROVIDED THAT SHOULD, BEYOND QUESTION, HAVE CAUSED THE COMMENCEMENT OF THE KIND OF SEARCHING INVESTIGATION I DESCRIBED, WITH THE POSSIBILITY THAT BILLS OF INDICTMENTS WOULD HAVE BEEN RETURNED.

MR. CHAIRMAN, THANK YOU FOR YOUR KIND ATTENTION.

Chairman **Pickle**. I would ask that you do that.

How many additional criminal investigations would be required to affect the behavior of the criminal element now involved with ERISA plans?

Would you venture a guess?

Mr. **Maria**. I don't know if there is an answer to that, Mr. Chairman. My response would be to have a vigilant and very capable diagnostic effort to be able to detect criminal activity, and be able to—here's a point that hasn't been mentioned yet——

Chairman **Pickle**. All right.

Mr. **Maria**. I understand that there has been a representation that the civil process has a unique ability to recover assets. Let me tell you about the criminal investigative process and things we do.

When we execute a search now—and we have already done this—we are in a position to seize assets directly traceable to the illegal activity under the provisions of the money laundering statutes.

That has already been done. We are in a position now to employ the provisions of U.S.C. title 18, section 1345. When investigating fraud, we can petition the court to impose a receiver for a benefit plan for the duration of the criminal investigation. And, indeed, we, for the most part, have become involved in and investigate predicate action and that enables us to seek forfeiture.

We don't argue about restitution. We determine what was lost, seek forfeiture, get an indictment, have those assets frozen, and, upon conviction, those assets belong to the Government. And the aggrieved third parties, the plan participants, will get first bite at the apple.

Chairman **Pickle**. All right.

Let me ask you, then, yesterday and today, particularly this morning, the General Accounting Office have testified, or they criticized both the PWBA and the Internal Revenue Service for failing to correctly focus their limited resources in those areas involving the greatest risk to the funds.

Now, given the very limited resources of all those agencies, including your own, particularly for criminal investigations, can you tell me which ERISA plans are most likely at risk?

Mr. **Maria**. Primarily those plans of small to medium-sized companies. As I said earlier, these are the plans that don't have adequate systems of internal control.

Chairman **Pickle**. Are you talking about defined benefit plans now?

Mr. **Maria**. We really haven't made a judgment as to whether defined benefit plans or defined contribution plans are more at risk.

Chairman **Pickle**. Well, let me—I must move on, but let me make this observation.

We have talked to the PWBA and the IRS. We heard from the inspector general, and the Assistant Secretary of Labor this morning. The Assistant Secretary has testified that in the past, they have not been able to target the funding aspects of these plans on form 5500.

The IRS had a TCMP approach that they have now discarded. They are going into a new computer approach which you just said wasn't very much to get excited about.

And I even said to one of the members this morning that they have not aggressively pursued these cases, I mean they looked into some of these civil cases, almost exclusively civil, and not criminal, but that they just didn't have a very good targeted approach. They didn't know what they were looking for and where they were going.

I said they are just kind of wandering in the dark out there. And to some extent, they, the IRS, and the PWBA cannot tell you exactly which case they ought to be looking at; which should be targeted; is it safe; is it funded. They just don't really know.

We are hoping that this new computer system is better. But at this point, I think they would admit, and I think you would admit, that generally speaking, they just don't know which one to go after for sure.

Now, on the other hand, you tell me that there is a lot of fraud and abuse and criminal activity, that the southern Mediterranean forces are at work in the pension plans, particularly in the small plans, and that the PWBA is not using your services, and that you have got the only experts who are trained in it to the extent that they ought to be.

But when I ask you can you tell me how many cases you have investigated, how many cases were bypassed and just left at the civil level, not the criminal, you cannot tell me.

And I have asked you two or three specific summaries of facts, and you cannot tell me.

Now, this is an individual making a statement. It seems to me that neither the Government agencies or the inspector general himself really knows what is out there. And I think probably you are saying that in so many words, that it's there and we haven't look at it, and we haven't done anything about it.

I don't want to be a bloodhound and say that we are going after all these cases because there are a lot of crooks. That would be terribly wrong. If there is only a small number of plans that are actually subjected to criminal violation, in some sense, we ought to be happy about it, because the funds are protected.

I think the Department of Labor feels that those funds are being well audited and that the funds are there and we ought not to frighten people.

At the same time, I think we have got to admit, as you have insisted, that human nature is such that when there are 900,000 plans, and assets in the neighborhood of $2 billion, human nature is such that a lot of that money is going to be siphoned off or embezzled or stolen by professionals and by people who just have a weakness for money.

Now, that is a sort of a balancing—a balanced criticism of both what your office is doing and what the Labor Department is doing.

But I just think that what you have said must be taken into account. I don't think we ought to take your statements just to scare people.

I think we should do more in this field. But we do need more facts. We need data. So I ask you, Mr. Maria, to contact my subcommittee and we will see that you get cooperation from the PWBA and the Justice Department or the Labor Department, because we need to have more cooperation.

Earlier this morning, I had the feeling that everyone said we are working together and we are a close family, and that doesn't seem to be just exactly the way it is. But I think we have got to look into this much further, because the rights of the individual to the money that they have earned, and that they should have when we retire, may be in jeopardy in some cases, perhaps in many cases.

So, I am not going to try to pass judgment on the validity of your statements or the criticisms might be levied by the other side, but to say that I think this committee and the other congressional committees of jurisdiction will be looking into all this.

So I want to thank you for your statement, and if you have got any additional facts or statements you would like to give our committee, we would welcome it.

So have you got any other statement to make before we go on to the next panel?

Mr. MARIA. I have nothing else.

Chairman PICKLE. Do you challenge my statement?

Mr. MARIA. I am reluctant, nor would I entertain doing that, Mr. Chairman. I think yours is an accurate and balanced conclusion.

There just needs to be a recognition that look, there are vulnerabilities, there are criminals out there, and they need to be pursued as effectively as we can do it and to make certain that punishment—so people will understand that if you commit certain crimes, there is a likelihood you will be caught—will be commensurate with the crime, and through that we build a meaningful deterrent.

That is the best we can hope for.

Chairman PICKLE. I appreciate your statements and you conclusions, and I thank you for your testimony.

Mr. Anthony, do you have any questions?

Mr. ANTHONY. The nature of a statement in a question, Mr. Chairman.

This morning during "1 minutes" in the House of Representatives there were several people that talked about the need for an independent prosecutor to be appointed to investigate the savings and loan scandal and crisis, basically complaining that the Justice Department was not doing a proper job of prosecuting fraudulent cases that had been referred to their department.

What bothers me from looking over your testimony and hearing your exchange with the chairman is that here is an independent inspector again saying, here are the red flags, I have got them up in the breeze. They are blowing. They are flapping, and I am telling everybody that will listen that there is trouble brewing, and something needs to be done.

And I think we need to take your advice to heart. But I would hope that we would get better cooperation out of the rest of the administration in terms of providing the raw data, because it would be devastating if we came back here a year later only to have you retestify to say that I warned you that a crisis was coming, and now the crisis is there, and then have other Members of Congress go back and ask for an additional independent prosecutor in these cases.

Are our fears unfounded in that regard?

Mr. **Maria**. I would like to clarify one point. I have no quarrel with the Criminal Division of the Department of Justice in terms of its support here in Washington at main Justice and through its operating appendages, the U.S. attorneys.

They have been extremely supportive and very effective in supporting prosecution of our employee benefit plan investigations.

My quarrel is with the Office of Legal Counsel which teamed up some 2 years ago with what I call the policy and politics folks at the Department of Labor and decided that the Office of Inspector General's Office of Investigations shouldn't be conducting these kinds of investigations which really restricted our scope.

And that is why we have two bills today, one in the Senate and one in the House, H.R. 4617, to basically overcome what I think was just a notoriously bad opinion from the Department of Justice Office of Legal Counsel.

Look, you don't have to be a rocket scientist to recognize fraud, abuse, and corruption, and the purposeful, malicious acts deserve to be prosecuted.

We have trained Federal criminal investigators that can be used, indeed the only ones in the department, why not use them? Are you going to hire more people without using the ones you have? That doesn't make a lot of sense today.

Chairman **Pickle**. I think you have got the red flag out. It's up to us to make sure that the administration clearly sees the error of their policy and politic ways, as you put it.

The witnesses yesterday called it badges of fraud. I guess that is what we are trying to determine, whether or not the policy is incomplete if you go strictly civil, civil only, or civil for a long time before you decide to go criminal.

But I thank you for your testimony.

Thank you, Mr. Maria. We will keep in touch.

The next witness will be John Keeney, Deputy Assistant Attorney General, the Criminal Division of the Department of Justice.

Mr. Keeney.

STATEMENT OF JOHN C. KEENEY, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE, ACCOMPANIED BY JERRY TONER, ASSISTANT CHIEF FOR LABOR MANAGEMENT RACKETEERING, ORGANIZED CRIME AND RACKETEERING SECTION

Mr. **Keeney**. Mr. Chairman, I have with me Jerry Toner, who is our expert in the labor corruption area. If you don't mind, I would like to have him beside me here to answer any questions.

Mr. **Anthony** [presiding]. His last name again?

Mr. **Keeney**. Toner, T-o-n-e-r, Mr. Anthony.

Mr. **Anthony**. Mr. Toner, you are welcome to come join Mr. Keeney at the table.

Mr. **Keeney**. Mr. Anthony, it's been a long hearing here, and I offer my statement for the record.

I would be glad to take about 4 or 5 minutes to summarize it, but I would be equally willing to just start into the questions, whichever you prefer, sir.

Mr. **Anthony**. Well, I think my preference would be for you to just give a 3- or 4-minute executive summary of the main parts of your testimony, and then I do have about four questions I would like to ask.

Mr. **Keeney**. Very good.

Mr. Chairman, in my prepared statement, I describe the ERISA-related crimes and set out some statistics concerning the number of those offenses referred to the U.S. attorney's offices for prosecution in recent years and the number of cases actually prosecuted.

Now, this was pursuant to the letter request of Chairman Pickle. I would emphasize that for reasons explained in my statement, these statistics probably understate the number of ERISA-related crimes actually prosecuted.

The Department of Labor and Federal Bureau of Investigation have joint authority to investigate ERISA-related crimes. This joint authority was established by a 1984 amendment of ERISA. Actually, two agencies—and this has been developed here today—within the Labor Department can investigate ERISA-related crimes, and these agencies and the FBI refer the matters directly to the appropriate U.S. attorney.

Such referrals at an early stage in the investigation allow the U.S. attorney's office to assist the investigation in the event grand jury process or other judicial procedures are required.

At least as important, an early referral also allows the U.S. attorney to render a preliminary opinion on the critical question of whether the case will be criminally prosecuted. In making that decision, and I know, Mr. Anthony, you are an experienced prosecutor and familiar with this process, the U.S. attorney has to consider such things as the prosecutive priorities in the Department of Justice and the priorities for his or her office.

Unfortunately, there are many more crimes referred to any Federal prosecutor's office than the office staff can possibly prosecute.

Accordingly, choices have to be made. When a criminal case is presented, the U.S. attorney has to take into account, in addition to prosecutive priorities, such things as whether a criminal prosecution is warranted because of the harm caused by the defendant, or to stand as a deterrent to others, and also, if the defendant's conduct also subjects him to a civil suit, the different burdens of proof that are involved in these civil and criminal cases

In an ERISA case, the prosecutor has to consider the unique consequences that result from an ERISA conviction. A criminal conviction of certain crimes can result in disqualification of the convicted individual from holding certain offices in or otherwise influencing an employee benefit plan for a period of 13 years following sentence, or the end of imprisonment, whichever is the later date.

This is one thing that our prosecutors take into account in deciding whether an ERISA case should be prosecuted criminally. In assessing an ERISA matter, our prosecutors, of course, take into account the views of the investigative agency like the Department of Labor. The key here, as in some areas, is coordination with the investigative agency, something we strongly encourage the U.S. attorneys to do.

At the headquarters level, we in the Criminal Division try to coordinate our work in the ERISA area with the Labor Department, as Mr. Maria has indicated.

I might add in response to Chairman Pickle's written question, that we would have to oppose any attempt to authorize attorneys employed by another department, such as the Labor Department, to prosecute criminal cases independently of the Justice Department. We think the ultimate prosecutive decisionmaking must remain with an individual U.S. attorney.

Nevertheless, there may well be cases when attorneys employed by another department can add valuable expertise to the prosecution of a case; and in these situations, we appoint the attorney from the other agency as a special assistant U.S. attorney.

Recently, 17 Department of Labor attorneys held such appointments. In sum, Mr. Chairman, we think the best way to enforce ERISA is through a good mix of criminal and civil enforcement with the caveat that the ultimate prosecutive decisions must be made by the U.S. attorneys.

Mr. Chairman, that concludes my summary of my remarks. I would be glad to try to answer any questions.

[The prepared statement follows:]

STATEMENT OF JOHN C. KEENEY
DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION
U.S. DEPARTMENT OF JUSTICE

Good morning, Mr. Chairman and members of the Subcommittee. I have been asked to respond to the Subcommittee's concerns with respect to the Department of Justice's enforcement of the crimes predicated on the Employee Retirement Income Security Act (ERISA). Although other crimes of general application, such as mail fraud, have been used to reach the criminal abuse of employee benefit plans in the private sector, I will address my remarks primarily to those crimes for which the federal courts' jurisdiction is predicated on the presence of an employee pension or welfare benefit plan regulated by Title I of ERISA.

The majority of these criminal prosecutions have involved the three (3) felonies contained in Title 18 of the United States Code, namely, embezzlement and theft in connection with employee benefit plans (18 U.S.C. 664), bribery and graft affecting plan operations (18 U.S.C. 1954), and false statements in documents required by ERISA (18 U.S.C. 1027). Other crimes include one (1) felony and two (2) misdemeanors which were enacted as part of ERISA itself. These latter crimes proscribe prohibited employment of convicted persons by employee benefit plans (29 U.S.C. 1111), willful failure to comply with ERISA reporting requirements (29 U.S.C. 1131), and willful interference with participants' rights under ERISA or the plan (29 U.S.C. 1141).

By reason of a 1984 amendment of ERISA (29 U.S.C. 1136(b)), the Department of Labor and the Federal Bureau of Investigation (FBI) have joint authority to investigate ERISA related crimes. At the present time such crimes are investigated by the FBI and two agencies within the Department of Labor: the Pension and Welfare Benefits Administration (PWBA) and the Inspector General's Office of Labor Racketeering (OLR). Each of these agencies refers investigative matters directly to the appropriate United States Attorney in the federal judicial district or districts where the alleged crimes have been committed. We prefer that the investigators contact the United States Attorney's office at an early stage of the investigation. The United States Attorney's office is thereby available to assist the investigation in the event that grand jury process or other judicial procedures are required. The United States Attorney can advise the investigative agency at that time whether the alleged violation, if substantiated, would be considered for criminal prosecution in the light of the office's overall case load and prosecutive guidelines which the United States Attorney may have formulated with respect to such crimes. The Department of Justice encourages United States Attorneys to formulate prosecutive guidelines in cooperation with the investigative agencies within their respective judicial districts which participate in so-called Law Enforcement Coordinating Subcommittees.

With respect to the prosecution in United States v. Freel, 681 F.Supp. 766 (M.D.Fla. 1988), aff'd without opinion, 868 F.2d 1274 (1989), which Criminal Division employee and former Assistant United States Attorney Richard Poole discussed with the Subcommittee at a prior hearing, we understand that the United States Attorney's office believed that the case warranted criminal prosecution both because of the substantial financial harm to plan participants which had resulted from the defendant's fraudulent activities and the presence of evidence indicating that the defendant, as a plan trustee, clearly knew that he was not entitled to convert plan assets to his own use by lending plan monies to corporations controlled by him.

We understand that Mr. Freel's crimes resulted in the depletion of practically all plan assets worth approximately $770,000 and were committed despite the contrary advice of Freel's attorney and another trustee of the plan on numerous occasions. In a criminal prosecution involving abuse of plan assets, the Government bears a burden of proof which is greater than its burden in a civil action under ERISA for breach of fiduciary duty or the conduct of a statutorily prohibited transaction. In the civil action the presence of bad faith on the part of the defendant is not material to the Government's case. However, in a criminal prosecution under 18 U.S.C. 664, for example, the Government must prove beyond a reasonable doubt that the person who is charged with the embezzlement of plan assets, or the criminal conversion of monies from funds connected with ERISA plans, acted with a specific intent to wrongfully deprive the plan or fund of the use of its property. The prosecution must demonstrate that the defendant acted with knowledge that such use was contrary to the purposes and objectives of the employee benefit plan as set forth by statute, trust documents, or other regulations and instruments which govern the use of the assets in question. *See United States v. Andreen*, 628 F.2d 1236 (9th Cir. 1980) (conversion of plan assets by a plan attorney to the use of plan trustees in the form of unauthorized pension credits).

The Subcommittee should understand that as a matter of law a United States Attorney may seek to commence criminal prosecution upon proof that it is more probable than not that the defendant committed the crimes with which he is to be charged. However, Department of Justice policy imposes a higher standard and requires that no criminal prosecution be undertaken unless the federal prosecutor believes that admissible evidence is sufficient to obtain and sustain a conviction beyond a reasonable doubt. The federal prosecutor may not decline criminal prosecution for which such requirement is met unless in his or her judgment either no substantial federal interest will be served by federal prosecution or the defendant is subject to effective prosecution in another jurisdiction or there is an adequate non-criminal alternative to criminal prosecution. *Principles of Federal Prosecution* pp. 5 - 15 (U. S. Department of Justice July 1980). In assessing whether non-criminal sanctions are adequate, it should be kept in mind that a criminal conviction results in a statutory disqualification of the convicted individual from employment with an employee benefit plan. Conviction of crimes listed in 29 U.S.C. 1111 results in disqualification of the convicted individual for a period which extends until a maximum of thirteen (13) years following sentence or the end of imprisonment, whichever is the later date.

According to the Executive Office for United States Attorneys, 374 investigative matters involving 512 subjects and ERISA related crimes were referred to United States Attorneys' offices for prosecutive consideration between October 1, 1984, and March 31, 1990. During that same period criminal prosecution was initiated in 140 cases involving 182 defendants where an ERISA related crime was charged as the primary substantive violation of the indictment or criminal information. Prosecutions during that period resulted in the conviction of 151 defendants in 123 cases and acquittal or dismissal of 14 defendants in 10 cases where the primary substantive violation in the indictment or criminal information was an ERISA related crime. I wish to emphasize, however, that these numbers reflect only those matters and cases in which the ERISA related crime was the primary matter under investigation or reported by a United States Attorney as the most important count of the criminal information or indictment. For example, these numbers would not reflect cases in which some crime other than the six (6) ERISA related crimes discussed here was reported as the most important crime charged or where the ERISA related crime was charged only as the predicate for another crime, such as conspiracy or violation of the Racketeer Influenced and Corrupt Organizations (RICO) statute. Sections 664 and 1954 are predicate crimes for

RICO. Accordingly, these numbers may understate the actual number of ERISA related criminal investigations, prosecutions, and convictions.[1]

The Office of the Inspector General at the Department of Labor has recently cited for special concern abuses involving organizations which purport to provide insurance-type benefits to small employers who seek to lower their rising employee health care costs. It is anticipated that Criminal Division attorneys will closely monitor and participate directly in ERISA related prosecutions in this area involving so-called multiple employer welfare arrangements or MEWAs. Criminal Division attorneys have participated with Labor Department personnel and insurance regulators from more than thirty (30) states in two recent conferences held in Atlanta, Georgia and sponsored by the United States Attorney's Law Enforcement Coordinating Subcommittee for the Northern District of Georgia. As the result of a criminal prosecution by the United States Attorney's office in Fort Worth, Texas, a MEWA operator, whose fraudulent activities left subscribers with approximately $4 million in unpaid medical claims, was sentenced to fifteen (15) years in prison following his conviction for conspiracy, mail fraud and interstate transportation of property obtained by fraud. *United States v. Bobby E. Browning*, Cr. 4-88-175 (N.D. Tex. sentence imposed April 26, 1990). Texas insurance regulators had taken control of Browning's companies in 1985.

Sentences such as those imposed in the *Browning* prosecution demonstrate the value of criminal sanctions against those who seriously abuse employee pension and welfare benefit plans. The higher visibility which the prosecution receives, the greater the deterrent value of the conviction to others who would abuse their positions of trust in the employee benefit plan industry. For example, we are hopeful that the ten (10) year prison sentence, $1.6 million fine, and forfeiture of $4.5 million which were imposed on the defendant in *United States v. Schwimmer*, 700 F. Supp. 104 (E.D. N.Y. 1988) and 706 F.Supp. 6 (E.D. N.Y. 1989), *pndg. appeal following limited remand on scope of attorney-client privilege*, 892 F.2d 237 (2d Cir. Dec. 27, 1989), will have a similar deterrent effect on service providers to pension plans.

The *Schwimmer* case involved an investment advisor to two (2) union-sponsored pension plans located on Long Island, New York, who was convicted of tax evasion, conspiracy to defraud the United States of taxes, seventy six (76) counts of 18 U.S.C. 1954 violations, and RICO conspiracy based on theft of plan assets, obstruction of justice, and on the receipt of graft in violation of 18 U.S.C. 1954. The graft consisted of $16 million which Schwimmer and a co-defendant had received in the form of concealed commissions on approximately $95 million worth of investments in certificates of deposit -- some of which were issued by banks and savings and loan associations which have since failed or have been placed in receivership. As part of a multi-district prosecution of activities connected with the First United Fund organization, the Schwimmer case is believed to represent the largest financial transaction pursued as a criminal prosecution using the ERISA related statutes.

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[1] For example, when a search was made of those cases in which an ERISA related crime was the basis of conviction regardless of its importance in the indictment, a procedure which is possible only for fiscal years 1987 and later, the number of convicted defendants for the period from October 1, 1986 to March 1, 1990, rose from 103 to 154. Nevertheless, these numbers also exclude cases in which the ERISA related crime was charged only as a predicate for another crime such as conspiracy or RICO.

Similar retrieval problems are reflected in the data which the Department's Office of Legislative Affairs provided the committee by letter dated May 15, 1990. That letter described the number of ERISA cases opened by the FBI since 1985 and enclosed a list of convictions for the same period under the three felonies in Title 18 of the Code which the FBI reported that it was able to retrieve from its records. The FBI advises that it was only able to retrieve case initiation statistics for matters in which the investigative matter was classified as an ERISA or labor related case as contrasted with an investigation whose primary focus was some other crime, but which ultimately included prosecution of an ERISA related crime.

While we believe that Americans served by the employee benefit plan industry would benefit from increased reliance on criminal sanctions by the Federal Government, we recognize that there must be a mix of criminal and civil enforcement. Criminal sanctions can result in restitution of losses to employee benefit plan victims as part of a criminal sentence imposed after trial or as part of a plea bargain. Moreover, a sentence to probation may include a condition that a defendant make restitution. A defendant has a strong incentive to do so because his failure to comply with the conditions of probation may result in imposition of another sentence, including imprisonment. See 18 U.S.C. 3563 and 3663. Nevertheless, we realize that not every abuse of plan assets can be addressed by criminal enforcement.

Although we are gratified to learn that the Labor Department's recent request for an additional 130 positions related to ERISA enforcement may result in an increased use of criminal sanctions, we recognize that the Solicitor of Labor has significant civil litigating responsibilities under ERISA. This leads us to the Subcommittee's question concerning whether other Federal agencies, and specifically the Labor Department, should be permitted to conduct criminal litigation with respect to ERISA related matters. Because of the Solicitor of Labor's extensive civil responsibilities under title I of ERISA and because we believe that the United States Attorney must continue to be the single prosecutive voice with respect to criminal litigation in his district, we would not support legislation which would authorize attorneys employed by the Solicitor of Labor to independently pursue criminal litigation. We believe that existing procedures which permit United States Attorneys' offices to utilize attorneys from other agencies as Special Assistant United States Attorneys are fully adequate in those cases which require the specialized expertise of an attorney employed by the investigative agency. We are advised that as of April 1, 1990, for example, United States Attorneys were receiving the benefit of 2,084 Special Assistant United States Attorney appointments. Seventeen (17) of those appointments were being held by Department of Labor attorneys.

This concludes my prepared remarks. I will be pleased to entertain questions from the Subcommittee members.

Mr. ANTHONY. Mr. Keeney, before we go forward, if you could, Mr. Toner, just for the record tell us what your area of responsibility is.

Mr. TONER. Yes, Mr. Chairman. I am the Assistant Chief for Labor Management Racketeering in the Organized Crime and Racketeering Section. That unit of a few attorneys supports both U.S. attorneys and the Organized Crime Strike Force with respect to labor and ERISA matters.

Mr. ANTHONY. And you would be in charge of the division?

Mr. TONER. No. The Assistant Attorney General, Mr. Dennis, is in charge of the Criminal Division; and the Organized Crime Section is part of that.

Mr. ANTHONY. And you work on that Organized Crime Task Force?

Mr. TONER. Right.

Mr. ANTHONY. Do you have a comment, Mr. Keeney?

Mr. KEENEY. No. I thought you were referring to my position in this set up.

Mr. ANTHONY. I am just trying to find out what kind of talent we have at the table.

My question to both of you is based on my reading of the testimony, and listening to the witnesses, it appears that PWBA has a policy of completing civil investigations before initiating criminal investigations. I just wondered if you would comment on the validity of that policy from your viewpoint?

Mr. KEENEY. Well, the preferred approach as far as the Department of Justice is concerned, Mr. Anthony, is that PWBA or any other agency which is investigating a matter, even a civil matter, if at the earliest stage that they find some indicia or badges of fraud, or other violations of the law, that they should bring the matter to the U.S. attorney for a determination as to whether or not, if proven, this is the type of matter that would be criminally prosecuted.

Now, you have to keep in mind that when someone walks in the door with an allegation and the allegation on its face appears to be a violation of law, that isn't necessarily the time to go to the U.S. attorney.

You do have to do—have some verification of the information and some indication that what you are dealing with in the way of allegations has reliability.

We prefer an early contact, bottom line, early contact with the U.S. attorney if there is any indication of criminality.

Mr. ANTHONY. So as the witness stated yesterday, when it's obvious that there is a badge of fraud, then you would love to see an early referral. You are saying that an early referral would be important for the expert criminal investigators to make sure that an appropriate decision was made in toto in terms of whether to pursue criminally or civilly or jointly?

Mr. KEENEY. I don't know whether I would say early referral. I would say early consultation, and then the consultation may result in the U.S. attorney, in effect, accepting the referral and becoming——

Mr. ANTHONY. But at the moment, you are not getting that early consultation?

Mr. **Keeney**. Apparently we are not getting early consultation, according to Mr. Maria. You know, we haven't gone into the——

Mr. **Anthony**. You know, Mr. Maria was kind of picking on you a little bit, too. You heard his comment about—I would have to pull up the record to see exactly what he said, but he phrased some opinion that was made of the Department of Justice was not using the best judgment in terms of restricting the inspector general's office of their investigations, ability to conduct criminal investigations of the ERISA claim.

Mr. **Keeney**. Actually, in his recent remarks, he was very commendatory of the Criminal Division. He was focusing his criticisms on the Office of Legal Counsel, which makes a determination on legal issues which have wide ranging implications.

They were asked by the Department of Labor or Solicitor to give some guidance as to what was the scope of inspector generals' authority, and the bottom line on that was that the inspector generals generally do not have the authority to investigate program fraud.

But that opinion specifically, and I think it's clear from Mr. Maria's testimony, specifically excluded one component of Mr. Maria's office, which is the Office of Labor Racketeering. It does have the jurisdiction to investigate this type of fraud.

And, as a matter of fact, Mr. Maria, when he got the opinion—this is my understanding, he would have to correct this—has taken some of the people who are in the proscribed area from the Office of Investigations, who do not, under the opinion, have the authority to investigate in this area, and has detailed them to his Office of Labor Racketeering which does have such authority. And so, he is utilizing it, an effective utilization of personnel, I might say.

He is using them, and they do have, even under the opinion, the authority to investigate. But that is the distinction. The OLC opinion impacts less on Mr. Maria's operation than it does on a lot of the other I.G.'s, but I will concede it does impact on it.

Mr. **Anthony**. Well, if in your decision coordination, and early coordination, and consultation is the key, it appears that that could be some type of impediment to having total cooperation and total coordination.

I will have to go back and examine it a little bit closer. But that appears at first brush to have at least a dampening influence on early coordination and cooperation rather than something that would be positive.

Mr. **Keeney**. You mean the OLC opinion, sir?

Mr. **Anthony**. Yes. At least it's on the record. I am a little bit more concerned about your opinion about the work product coming out of PWBA in terms of cases that have been referred to your Department for criminal prosecution.

What has the work produce been like?

Mr. **Keeney**. Well, there have been a limited number of cases. And you had the testimony here yesterday from one of the attorneys in the Criminal Division who tried one of those cases. He spoke very highly in conversation with me on the quality of the investigative work done by the particular agent who handled his matter.

I cannot really speak beyond that, because we don't see that many of them, Mr. Anthony.

Mr. **Anthony**. OK.

Have you requested to see more of them?

Mr. **Keeney**. Well, we are having——

Mr. **Anthony**. I mean, have you expressed this viewpoint through the internal workings of the agency and the administration to say that you think that this is an area that needs to be reviewed?

Mr. **Keeney**. The way we have addressed it, and maybe we should address it more, is through our participation in training programs which involve the PWBA.

Mr. **Anthony**. Well, I would like to underscore that, because the witnesses yesterday, indicated that you only received 3 weeks of training, and you also find out that that full 3 weeks didn't even include 3 weeks of investigation training.

Mr. **Keeney**. Let me make a point on the training, and I am not talking about the training down in Glynco, I am talking about training in which my colleague here participates and hopefully will participate more.

Not only are they given an idea of indicia of fraud, badges of fraud, but they are generally brought up to date on problems of criminal prosecution, what they should look for, and most importantly, they are given a name and they are given a telephone number within the Department of Justice of someone who can guide them with respect to those cases. That is Mr. Toner and his small staff.

But they are all very capable, and they really know how to guide someone in an investigation, if in fact it's something that should be done criminally.

Mr. **Anthony**. Well, you know, I have a whole host of white collar crime, and a whole host of different Federal statutes.

Mr. Toner, is there anything unique or any problems that are unique with investigating and prosecuting ERISA violations?

Mr. **Toner**. Well, I think the most important thing is a good, solid background in what the civil ERISA law entails, because we are finding that for the more sophisticated crimes you need to know where the Labor Department stands on the civil requirements. Because a bona fide compensation, for example, for services performed in the regular course of business is an exception to criminal liability under the bribery and graft statute, an investigator, when he goes in and looks at kickbacks in the form of compensation, commissions, and so forth, brokerage fees, needs to know what the civil regular course of business is. Of course, he needs to recognize other fraudulent activities which would warrant prosecution under that statute, but he needs that good, solid background.

Mr. **Anthony**. So in terms of the training, the training certainly needs to go to the basic understanding of the statute and the regulations and the implementations before you can even begin to detect whether or not there has been a suspicion of criminal activity.

Mr. **Toner**. Right. The criminal training is on top of that. And then the criminal training would have to come over and above that.

Mr. ANTHONY. The criminal training would have to come over and above that.

Mr. TONER. Right. And, of course, we want to add what Mr. Maria was talking about, which is the use of informants, the use of specialized techniques for gathering information that trained criminal investigators use.

Mr. ANTHONY. Which basically is solely within the realm of the criminal investigations, rather than civil investigations.

Mr. TONER. Right. Generally.

Mr. KEENEY. But at a certain point, Mr. Anthony, we do bring in, if we feel it's something that warrants serious criminal investigation, the experienced criminal investigators, whether that would be Mr. Maria's office or the FBI or the Internal Revenue Service or maybe all three.

Mr. ANTHONY. Can you think of any remedial legislation that you could recommend to this Oversight Subcommittee in this area, or do you think it's basically within the administrative body of the current law?

Mr. KEENEY. Directly related to the pension-welfare law?

Mr. ANTHONY. Yes, sir, mainly on investigations and prosecutions, can you think of any remedial legislation that you could recommend to this Oversight Subcommittee, or am I hearing that it's basically the way the present situation is administered?

Mr. KEENEY. The way it's administered. We would encourage PWBA to look more closely at the various matters that they investigate and bring the U.S. attorney in at an early stage.

But that would be an educational process.

Mr. ANTHONY. Just as a matter of curiosity, have you ever prosecuted criminally a defendant where restitution has been made on the civil side?

Mr. KEENEY. Where it's been made prior to criminal prosecution?

Mr. ANTHONY. Yes.

Mr. KEENEY. I don't know whether we have or not. I would have to think a little bit about that, but there is no reason why in an appropriate case we wouldn't do it.

If somebody returned the money because they knew that the jib was up, as it were, and they were about to be looked at criminally, we would give that a great deal of consideration, when we considered criminal prosecution.

In some cases, restitution with other circumstances would be a factor you would consider in prosecuting.

In some other cases, the total circumstances may well overwhelm the fact of restitution.

Mr. ANTHONY. I wish you could do two things for me. One, ascertain whether or not your Department has, in fact, prosecuted criminally a case where there has been prior restitution, which was either offered or actually was made. If the answer is no, then I want you to try to ascertain as to whether or not there has been any—if there is any policy that states that those cases are not to be referred from the Department of Labor from PWBA to the Justice for prosecution.

[The following was subsequently received:]

U.S. Department of Justice

Criminal Division

Deputy Assistant Attorney General

Washington, D.C. 20530

RECEIVED
SEP 12 1990
Ways and Means
Subcommittee on Oversight

SEP 4 1990

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

At the hearing on June 13, 1990, before the House of Representatives, Committee on Ways and Means, Subcommittee on Oversight, Congressman Beryl Anthony requested the Department of Justice to provide the Subcommittee with information regarding cases involving employee benefit plans which were referred to the Department of Justice for criminal prosecution after restitution had been made pursuant to successful civil litigation. We have enclosed a copy of the portion of the transcript of the Subcommittee proceeding in which Mr. Anthony made his request.

In response to Mr. Anthony's request we have enclosed a summary description of cases investigated by the Pension and Welfare Benefits Administration, U.S. Department of Labor, that were referred to the Justice Department following restitution pursuant to successful civil litigation or voluntary compliance. We hope this information is responsive to Mr. Anthony's request. Please contact this office if we can be of further assistance in this matter.

Sincerely,

John C. Keeney
Deputy Assistant Attorney General

Enclosure

U.S. Department of Justice

Criminal Division

Deputy Assistant Attorney General

Washington, D.C. 20530

JUN 28 1990

Mr. Charles Lerner
Director of Enforcement
Pension and Welfare
 Benefits Administration
U. S. Department of Labor
Washington, D. C. 20210

Dear Mr. Lerner:

At a hearing on June 13, 1990, before the House of Representatives, Committee on Ways and Means, Subcommittee on Oversight, Congressman Anthony requested the Department of Justice to provide the Subcommittee with information regarding cases investigated by your office that were referred to the Department of Justice for criminal prosecution after restitution had been made pursuant to successful civil litigation. The purpose of this letter is to request that you provide the Justice Department with information that would assist us in complying with that request. We understand that Frank Clisham of your St. Louis office may have made reference to such a case at the conference sponsored by your office recently in Boulder, Colorado. We have enclosed a copy of the portion of the transcript of the Subcommittee proceeding in which Mr. Anthony made his request.

We would appreciate your response to this request as soon as possible. Thank you for your assistance.

Sincerely,

John C. Keeney

John C. Keeney
Deputy Assistant Attorney General
Criminal Division

Enclosures

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington D.C. 20210

AUG - 8 1990

Mr. John C. Keeney
Deputy Assistant Attorney General
U.S. Department of Justice
Criminal Division
Washington, D.C 20530

Dear Mr. Keeney:

Pursuant to your letter of June 28, 1990, the following is a brief narrative of several of the cases investigated by the Pension and Welfare Benefits Administration that were referred to the Department of Justice after restitution had been made pursuant to successful civil litigation or voluntary compliance.

1. Jack Nickelson

On June 27, 1989, the Labor Department obtained a judgment resolving a civil complaint against Nickelson, his son and his company in connection with $1,038,000 in prohibited loans and transfers made from the plan to pay personal expenses and finance the operations of his company.

Under the judgment, the Nickelsons were ordered to pay $1,700,404 to the plan as restitution for the prohibited loans and transfers.

On December 11, 1989, in a related criminal case, Nickelson, trustee of the Southwestern Rubber and Packing Company Profit Sharing Plan and owner of the company was ordered to repay $280,000 to the plan and received a five year suspended prison term and probation for embezzling assets of the plan.

2. Glen E. Dawson

In August of 1986, the Department brought a civil suit in federal district court against Chesapeake Pension Consultants, Inc. (CPC) and its principal owner, Glen E. Dawson for improperly accepting money from a mortgage banker in exchange for investing the assets of various employee benefit plans in the bank's mortgages.

Dawson entered into a Consent Order with the Department in the civil action whereby Dawson agreed to repay the amount invested in the bank's mortgages equal to the pro-rata share invested by each of the plans administered by Dawson which invested in such mortgages, totaling approximately $70,000.

In a related criminal case, Dawson pled guilty in April of this year to embezzling approximately $168,0000 from the pension plan of Stern Office Furniture. CPC served as a fiduciary to the company's pension plan.

Dawson was ordered to pay $100,000 in restitution and was sentenced to serve six months in a security or community treatment facility for embezzling assets of an employee benefit plan.

3. Michael R. Tamucci, Retail Wholesale & Department Store Union Pension and Health and Welfare Plans

On December 18, 1985, PWBA opened a civil investigation based on allegations that Tamucci engaged in prohibited transactions and used monies of the Funds to make a $5,000 gift to Knoxville College. The case was pursued through civil litigation, resulting in RSOL negotiating a settlement agreement which restored all losses including interest, which occurred as a result of the prohibited transactions and the gift to Knoxville College.

PWBA's criminal investigation resulted in a referral to DOJ for criminal prosecution. On February 11, 1987, the Assistant U.S. Attorney in Birmingham, Alabama, negotiated a pre-trial diversion agreement ordering restitution totaling $82,128.

4. Deena Packaging Industries Inc. (DPI) Profit Sharing Plan

Case involved the transfer of plan assets to the various banks of the trustee/administrator and to the corporate account of the sponsor. On June 1, 1987, the Court entered an order requiring DPI and the Plan Trustee, Mr. Gerald Ardito pay $707,169 to the Plan.

In March of 1987, the New York Area Office opened a criminal investigation based on allegations that Mr. Ardito, Plan Trustee, embezzled plan assets for his personal use. On October 6, 1987, in light of numerous factors, and because of the successful civil suit, the U.S. Attorney declined due to lack of prosecutorial merit.

5. Sheet Metal Workers Local #399 Health and Welfare Fund

On March 7, 1984, a civil investigation was opened to determine whether violations of ERISA had occurred. The case was pursued through voluntary compliance resulting in the recovery of approximately $6,000.

The criminal case was referred to the U.S. Attorney, however, the AUSA declined prosecution because the Office of Labor Management Standards had performed a criminal investigation on the Union and Plan and the Subject had entered into a plea agreement on one count of embezzlement from the Union and agreed to make restitution totaling $45,739.

6. Bernard and Jack Goldstein

In 1984, a reversal of a prohibited transaction in the amount of $782,674 was achieved civilly.

On February 26, 1986, Bernard Goldstein, president of LaBoucherie Bernard Ltd., and trustee of the Company's employee pension fund was sentenced to a three year prison term after pleading guilty to embezzling $25,000 from his employee's pension fund.

At the hearing of June 13, 1990, before the House of Representatives, Committee on Ways & Means, Subcommittee on Oversight, two PWBA investigations, Herbert Freel and Lundberg Industries, were discussed which resulted in both civil restitution and criminal prosecution.

So you noted in your letter, Frank Clisham, District Supervisor of the St. Louis Office, recently made reference to the case of Inter-Regional Inc. Profit Sharing Plan at the PWBA criminal training in Boulder, Colorado.

In March of 1989, a civil investigation was opened during which evidence was obtained suggesting a misappropriation of elective deferrals by an employee to her own account totaling $6,586.04. The employee was terminated, underwent rehabilitation for drug related problems and repaid the entire amount to the plan. Also, the retirement committee reviewed their systems and procedures to prevent similar occurrences in the future.

Predicated on the civil case, the St. Louis Area Office referred the case to the U.S. Attorney for possible criminal violations. The AUSA declined to prosecute the case criminally due to the remedial actions taken by the parties.

For your convenience I am enclosing a copy of the news announcements on most of these cases. We hope that this information will assist you in your response to Congressman Anthony and if you should need additional information please feel free to call me at (202) 523-8840.

Sincerely,

Billy Beaver

for Charles Lerner
Director of Enforcement

Attachments

cc: Gerald A. Toner ✓

News United States Department of Labor

Office of Information Washington, D.C. 20210

PENSION & WELFARE BENEFITS ADMINISTRATION USDL: 89-117

CONTACT: GLORIA DELLA
OFFICE: (202) 523-8921

FOR RELEASE: Immediate
Fri., March 10, 1989

LABOR DEPARTMENT OBTAINS TEMPORARY RESTRAINING ORDER FREEZING THE ASSETS OF TRUSTEES OF TEXAS PENSION PLANS

The U. S. Department of Labor has obtained a court order temporarily restraining the trustees and an individual affiliated with the pension plans of Lundberg Industries of Dallas from disposing of their business and personal assets without approval of the court or the Labor Department.

The court order was issued as the result of a lawsuit brought by the department against the defendants for violating the Employee Retirement Income Security Act (ERISA) by allegedly making over $7 million in loans and transfers from the pension plans for the benefit of Lundberg Industries.

Named as defendants were Thomas Lundberg, the president and principal owner of the company and trustee of the plans; John Sanders, a former plan trustee; and Joe Wall, an associate of Lundberg.

According to the department, the temporary restraining order was necessary to prevent "immediate and irreparable injury through the irretrievable loss, concealment, transfer and disposal of assets by the defendants" before resolution of its complaint against the defendants.

The Labor Department's original complaint alleged the trustees violated ERISA by causing the company's pension plans to:

- make a $2 million prohibited loan to Wall for the benefit of Lundberg Industries;
- make a prohibited transfer of $572,818.40 to Wall which was passed on to the company;
- imprudently make in excess of $1.55 million in loans to 127, Inc., a company established by Lundberg, which was transferred to Samuel Longo, another individual affiliated with Lundberg, shortly before the loan transactions; and
- transfer $3,649,637 in pension assets to the company without first paying all benefits due to the participants.

Wall was alleged to have knowingly participated in and financially benefited from certain of the improper actions of the trustees.

The temporary restraining order, which was based on the $2 million prohibited loan to Wall, establishes limits on the monthly expenditures of defendant Lundberg, Sanders and Wall for business and personal expenses, unless they obtain prior approval from the court or the Labor Department. The order also prohibits them from destroying or concealing any financial records relating to their assets, including transactions to purchase the assets of the Potash Company of America and loans by the plans to any of the defendants.

The temporary restraining order was entered on March 8 in the U. S. District Court for the Northern District of Texas, Dallas Division. A hearing will be held by the judge on March 13, 1989, to determine whether the temporary restraining order will be extended.

The court action resulted from an investigation conducted by the Dallas Area Office of the Labor Department's Pension and Welfare Benefits Administration.

# # # #

(Dole v. Lundberg)
Civil Action No. 3-88-2470-D

News United States
Department
of Labor

Office of Information Washington, D.C. 20210

PENSION AND WELFARE BENEFITS ADMINISTRATION USDL: 89-385

CONTACT: GLORIA DELLA
OFFICE: (202) 523-8921

FOR RELEASE: Immediate
Thurs., AUGUST 3, 1989

LABOR DEPARTMENT OBTAINS JUDGMENT AGAINST TRUSTEES OF LUNDBERG INDUSTRIES PLANS

The U. S. Department of Labor has obtained a partial summary judgment against trustees of the pension plans of Lundberg Industries of Dallas for making over $2.5 million in prohibited loans for the benefit of the company.

Lundberg Industries sponsored three defined benefit pension plans for some 840 participants employed by the potash mining company in Dallas, Tex., Carlsbad, N.M. and Dumas, Tex. In 1986, the three plans had cumulative assets in excess of $11 million.

The Pension Benefit Guaranty Corporation (PBGC) took over trusteeship of the plans in April 1988.

The Labor Department and PBGC filed parallel complaints on Oct. 4, 1988, alleging that trustees Thomas Lundberg and John Sanders violated the fiduciary provisions of the Employee Retirement Income Security Act (ERISA).

Joe Wall and Samuel Longo, associates of Lundberg, also were named for knowingly participating in and financially benefiting from the improper actions of the trustees.

The trustees were alleged to have violated ERISA by causing the pension plans to:

- make a $2 million prohibited loan to Wall for the benefit of Lundberg Industries;
- make a prohibited loan of $572,818.40 to Wall which was passed on to the company;
- imprudently make in excess of $1.55 million in loans to 127, Inc., a company established by Lundberg, which was transferred to Longo shortly before the loan transactions; and
- transfer $3,649,637 in pension assets to the company without first paying all benefits due to the participants.

On March 23, the department submitted a motion for partial summary judgment against the trustees with regard to the $2.5 million in prohibited loans made to the company through Wall.

The court concluded that the department's evidence had established the liability of the trustees for violating ERISA's prohibited transactions and self-dealing provisions. The court found that the defendants authorized the transactions which clearly resulted in prohibited loans to Lundberg Industries, a party in interest and the transfer to or use of plan assets by Lundberg, Sanders and others. The court held that the trustees benefited from the transactions by receiving needed capital for the company and substantial proceeds individually.

Based on the department's evidence, the court granted the department's motion for a summary judgment.

The partial judgment, entered July 14 in federal court in Dallas, resulted from separate civil investigations conducted by the Dallas Area Office of the Labor Department's Pension and Welfare Benefits Administration and the PBGC.

The department's litigation continues with regard to losses related to the claims resolved by the partial judgment and other substantive allegations contained in the complaint.

# # # #

(Dole v. Lundberg)
Civil Action No. CA3-2471-D

News United States
Department
of Labor

Office of Information Washington, D.C. 20210

PENSION & WELFARE BENEFITS ADMINISTRATION USDL: 90-87

CONTACT: GLORIA DELLA
OFFICE: (202) 523-8921

FOR RELEASE:
Wed., Feb. 14, 1990

FORMER PRESIDENT, ATTORNEY OF LUNDBERG INDUSTRIES CONVICTED OF EMBEZZLEMENT

The former president and the attorney for Lundberg Industries, a potash mining company, have been convicted on charges of embezzlement of more than $9 million from the company's pension plans.

Lundberg Industries sponsored three defined benefit pension plans for 840 participants employed by the company in Dallas, Texas, Carlsbad, N.M., and Dumas, Texas. The Pension Benefit Guaranty Corporation (PBGC) took over trusteeship of the plans in April 1988.

Thomas D. Lundberg, former president of the company, and attorney John Sanders were convicted Feb. 13 in federal district court in New Mexico after a jury trial. Lundberg was convicted on six counts of embezzlement and conspiring to embezzle more than $7.6 million from the company's pension plans. Sanders was convicted on three counts of embezzlement of $5.6 million and conspiracy to embezzle assets of the plans.

"These criminal convictions, together with the civil judgment, demonstrate how the Department of Labor's enforcement program works to protect plan assets and punish wrongdoers," said Assistant Secretary of Labor David George Ball.

"The cooperation between the department and the U. S. Attorney in Albuquerque was essential to the successful prosecution of this case. We will relentlessly pursue fraud and abuse with all available enforcement authority," he said.

The defendants were indicted in March 1989 on charges of mail fraud, aiding and abetting, embezzlement and conspiring to embezzle over $9 million in pension funds. In addition to Lundberg and Sanders, the other defendants charged in the indictment were Clarence David Donaldson, a Dallas insurance agent, David J. Boatwright, a Nashville actuary, and Samuel Longo, a Los Angeles investment banker. Donaldson, Boatwright and Longo all entered guilty pleas to reduced charges and testified during the trial. Before testifying at the trial, Joe Wall, a Nashville, Tenn., financial consultant and unindicted co-conspirator, pled guilty to violations of conspiracy and filing false ERISA reports on Jan. 18, 1990.

Lundberg faces a maximum sentence of 30 years in prison and $60,000 in fines. Sanders faces a maximum sentence of 15 years in prison and $30,000 in fines. Sentencing is scheduled for May 4.

Civil complaints were filed by the Department of Labor and PBGC in October 1988, alleging violations of the Employee Retirement Income Security Act (ERISA). In the civil case, a Dallas federal court awarded a partial summary judgment against the plans' trustees with regard to prohibited loans made to benefit the company. Litigation continues in the civil case.

The conviction resulted from the cooperative efforts of the Dallas Office of the Labor Department's Pension and Welfare Benefits Administration, the department's Office of the Inspector General, U. S. Attorney's Office in New Mexico, which prosecuted the case, and the New Mexico Offices of the District Attorney and Attorney General.

# # #

(U. S. v. Lundberg)
Criminal No. 89-134

News United States Department of Labor

Office of Information Washington, D.C. 20210

PENSION & WELFARE BENEFITS ADMINISTRATION USDL: 86-95

CONTACT: GLORIA DELLA
OFFICE: (202) 523-8921

FOR RELEASE: Immediate
Friday, March 7, 1986

TWO MARYLAND MEN SENTENCED IN SEPARATE CRIMINAL CASES FOR EMBEZZLING EMPLOYEE BENEFIT PLAN FUNDS

A federal court in Baltimore sentenced George W. Blood, of Timonium, Md., to five years in prison for embezzling over $144,000 from a prepaid legal service plan as well as tax evasion, and to concurrent sentences for falsifying records, the U.S. Department of Labor announced today.

Blood received a concurrent five year prison term on each of four counts of tax evasion, and a three-year concurrent sentence for falsifying records and failing to file required annual reports with the government. Also, he received a suspended sentence on the charges that he willfully failed to file the annual reports.

Blood, president of the Fortement Association, Inc., and trustee and administrator of several group prepaid legal plans, also was given five years' probation, to commence after he serves the prison term for embezzlement. He must report to the U.S. Marshals to begin his prison term on April 7.

A federal jury indicted Blood in September 1984 for embezzling over $155,000 in money, securities, property and other assets from the Fortement Association Prepaid Legal Trust. The indictment also charged he knowingly concealed the fact that he had disbursed plan funds to corporations under his control, failed to file annual reports, and falsified income tax returns for the years 1979 to 1982.

In a separate action, Bernard H. Goldstein of Chevy Chase, Md., was sentenced to a three-year prison term after pleading guilty to embezzling $25,000 from his employees' pension fund. Goldstein was the trustee of the LaBoucherie Bernard, Ltd. pension fund, and president and major stockholder of the company.

He was sentenced on Feb. 26, 1986 by a federal court in the District of Columbia.

The sentencing in both cases resulted from criminal investigations conducted by the Washington District Office of the department's Pension and Welfare Benefits Administration (PWBA) in conjunction with the Federal Bureau of Investigations, the Internal Revenue Service, and the U.S. Attorney's Offices in Baltimore and Washington, DC.

# # # #

News
United States
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of Labor
Office of Information
Washington, D.C. 20210

PENSION & WELFARE BENEFITS ADMINISTRATION USDL: 88-22

CONTACT: GLORIA DELLA
OFFICE: (202) 523-8921

FOR RELEASE: Immediate
Thursday, January 21, 1988

FORMER OWNER OF FLORIDA DAIRY COMPANY CONVICTED
OF EMBEZZLING NEARLY $800,000 FROM PROFIT SHARING PLAN

Herbert L. Freel, former owner of Charles McArthur Dairy Farms, Inc. and its subsidiaries of Okeechobee, Fla., has been convicted on six counts of mail fraud and one count of embezzling nearly $800,000 from the firms' profit sharing plan.

The profit sharing plan, which is governed by the Employee Retirement Income Security Act (ERISA), covers approximately 108 participants who worked for the companies.

Freel was convicted on Jan. 8 following a jury trial in the U. S. District Court for the Middle District of Florida on charges he defrauded the profit sharing plan by making loans from the plan to two corporations set up by him under his daughter's name and for engaging in mail fraud to further his scheme to embezzle plan funds.

Freel, who had been indicted on Nov. 13, 1986, faces a maximum penalty of 35 years in prison, $16,000 in fines and restitution to the plan.

The criminal action follows a 1984 civil complaint filed by the Labor Department against Freel. The civil complaint had alleged that Freel violated ERISA by making prohibited loans, representing approximately 75 percent of the plan's assets, to companies wholly-owned by his daughter.

A federal court in Orlando subsequently ordered the defendant to repay to the plan the outstanding balances on the loans with interest.

Both the criminal and civil actions resulted from investigations conducted by the Labor Department's Pension and Welfare Benefits Administration (PWBA) Miami District Office.

# # # #

U.S. v. Freel
Criminal No. 86-18CR-OC12

News United States Department of Labor

Office of Information Washington, D.C. 20210

PENSION AND WELFARE BENEFIT PROGRAMS USDL: 84-428

CONTACT: Gloria Della
OFFICE: (202) 523-8921

FOR RELEASE: IMMEDIATE, Wednesday
October 10, 1984

FEDERAL COURT ORDERS FLORIDA TRUSTEE TO PAY OVER $880,000 TO PROFIT SHARING PLAN

A federal court in Orlando, Florida yesterday ordered Herbert L. Freel of Oklawaha, Florida to pay over $880,000 to the profit sharing plan of Modern Dairy Farms and its related employers.

The order stems from a U.S. Labor Department suit, filed Oct. 2, 1984, against plan trustee Freel for violating the Employee Retirement Income Security Act (ERISA).

According to the suit, Freel breached his fiduciary obligations by making loans totalling $770,500, some 75 percent of the plan's assets, to two firms wholly-owned by his daughter Dana Freel.

The suit contended Freel violated ERISA's prohibition against plan loans to a party in interest, as well as the Act's requirement that plan investments be diversified to minimize the risk of large losses.

The court order directs Freel to reimburse the plan for the balance of the unpaid principal of the loans, plus accrued interest. This interest amounts to $114,716 through Sept. 30, 1984, with additional interest due until the loans are fully repaid.

Barnett Banks Trust Company, N.A. has been appointed by the court as successor trustee to the plan.

# # # #

News United States Department of Labor

Office of Information Washington, D.C. 20210

PENSION & WELFARE BENEFITS ADMINISTRATION USDL: 88-579

CONTACT: GLORIA DELLA
OFFICE: (202) 523-8921

FOR RELEASE: Immediate
Friday, Nov. 18, 1988

LABOR DEPARTMENT OBTAINS JUDGMENT AGAINST MARYLAND PENSION CONSULTANT OVER MISUSE OF PENSION ASSETS

The U.S. Department of Labor has obtained a court judgment barring an Annapolis, Md. pension consultant and his company from providing services to any employee benefit plan governed by the Employee Retirement Income Security Act (ERISA).

The judgment against Glen E. Dawson and his company Chesapeake Pension Consultants, Inc. (CPC) resolves allegations contained in a Labor Department complaint originally filed in August 1986 and subsequently amended.

The defendants served as many as 200 employee benefit plans governed by ERISA. Dawson and CPC also were trustees to several of the plans.

The department's complaint alleged that the defendants imprudently caused plans they served to invest in numerous mortgages and other investment products to benefit themselves. The department contends the plans suffered substantial losses stemming from these investments.

According to the complaint, Dawson and Chesapeake violated their fiduciary duties under ERISA when they:

- caused plans to invest in mortgages in exchange for fees and commissions from First American Mortgage and purported mortgages with Michael H. Clott;
- conducted little or no investigation into the legitimacy of mortgage investments with Clott, some of which were non-existent;
- caused plans to invest in entities which Dawson controlled or had a financial or other interest in, including CPC, Ridgeway Savings and Loan Association and Bay Investments, Inc.; and
- filed annual reports with the Labor Department bearing unauthorized facsimile signatures of an enrolled actuary.

The judgment permanently enjoins the defendants from providing services of any kind to plans covered by ERISA and requires them to furnish a copy of the court order to each plan which have been parties in interest.

In addition, the judgment requires Dawson to repay $70,000 to the plans to which he and his company provided services. The defendants filed for bankruptcy subsequent to filing of the department's complaint.

The consent order and final judgment was entered on Nov. 10 in the U.S. District Court for the District of Maryland at Baltimore.

# # # #

(McLaughlin v. Dawson)
Civil Action No. JFM 86-2536

News United States Department of Labor

Office of Information Washington, D.C. 20210

PENSION & WELFARE BENEFITS ADMINISTRATION USDL: 86-359

CONTACT: GLORIA DELLA
OFFICE: (202) 523-8921

FOR RELEASE: Immediate
Tuesday, August 26, 1986

LABOR DEPARTMENT SUES TWO MARYLAND FIRMS, PRINCIPAL OWNER FOR MISUSE OF EMPLOYEE BENEFIT PLAN ASSETS

The U.S. Department of Labor has sued two Maryland companies and their principal owner for improperly accepting money from a mortgage banker in exchange for investing the assets of various employee benefit plans in the bank's mortgages.

Chesapeake Pension Consultant, Inc.; Severn Mortgage Service Company, Inc.; and Glen E. Dawson, their principal owner, were named as defendants. The companies provide administrative services to approximately 200 plans governed by the Employee Retirement Income Security Act (ERISA). Dawson also is a trustee to several of the plans served by his companies.

The complaint alleges that the companies and Dawson violated their fiduciary duties under ERISA by causing and advising plans which they administered to invest in mortgages issued by First American Mortgage Company in exchange for being paid placement fees and commissions by First American. The defendants also are alleged to have used plan funds for their personal benefit by accepting the fees and commissions.

Dawson and Chesapeake allegedly caused the Fexa-Kurcher Plan, Fairway Springs Plan, and the Swain Plan to acquire shares of Chesapeake preferred stock and improperly filed annual reports with the Labor Department bearing unauthorized facsimile signatures of an enrolled actuary.

ERISA prohibits the direct or indirect use of plan money for the benefit of persons or companies affiliated with a plan.

The complaint asks the court to require that the defendants reimburse the plans for any losses resulting from their violations of ERISA, to enjoin them from serving as a fiduciary, service provider or consultant to any plan governed by ERISA, and to prohibit them from engaging in future violations of the law.

The complaint was filed in U.S. District Court for the District of Maryland at Annapolis.

# # # #

(Brock v. Dawson)
Civil Action No. HM 86-2536

News United States
Department
of Labor
Office of Information Dallas, TX 75202

USDL-PWBA-89-161-12-19

CONTACT: Sherrie Moran
OFFICE: (214) 767-4776

FOR RELEASE: Immediate
Tuesday, Dec. 19, 1989

HOUSTON TRUSTEE SENTENCED FOR EMBEZZLING PENSION ASSETS

The trustee of the Southwestern Rubber and Packing Company profit sharing plan and owner of the company was ordered to repay $280,000 to the plan and received a five year suspended prison term and probation for embezzling assets of the plan.

The court action resulted from an investigation conducted by the Dallas Area Office of the Labor Department's Pension and Welfare Benefits Administration.

Jack W. Nickelson was previously indicted by a grand jury on Oct. 18, 1988, for embezzling $485,000 from an employee benefit plan governed by the Employee Retirement Income Security Act (ERISA).

He pled guilty on Oct. 30, 1989, to embezzling $100,000 in assets of his company's pension plan. He faces $10,000 in fines and five years imprisonment on each of the thefts. He was sentenced Dec. 11.

The Labor Department obtained a judgment on June 27 resolving a civil complaint against Nickelson, his son and his company in connection with $1,038,000 in prohibited loans and transfers made from the plan to pay personal expenses and finance the operations of Southwestern Rubber, a company owned solely by him. He allegedly transferred nearly all of the plan's assets to himself and the company in violation of ERISA's diversification requirement and failed to report those transfers, concealing the prohibited transactions.

Robert Nickelson, Jack Nickelson's son, was alleged to have knowingly participated in the improper actions of his father by receiving a $100,000 loan made with plan assets.

Under the judgment, the Nickelsons were ordered to pay $1,700,404 to the plan as restitution for the prohibited loans and transfers.

The civil complaint was filed on June 16, 1988 in Federal District Court in Houston.

# # # #

(U.S. v. Nickelson)
Criminal No. H-88-356

(Dole v. Nickelson)
Civil Action No. H-88-2022

News United States Department of Labor

Office of Information Washington, D.C. 20210

PENSION & WELFARE BENEFITS ADMINISTRATION USDL: 88-546

CONTACT: GLORIA DELLA
OFFICE: (202) 523-8921

FOR RELEASE: Immediate
Monday, Oct. 31, 1988

TRUSTEE INDICTED FOR EMBEZZLING $485,000 FROM HOUSTON PENSION PLAN

Jack W. Nickelson, the owner of Southwestern Rubber and Packing Company of Houston and a trustee of the company's profit sharing plan, has been indicted on 10 counts of embezzling $485,000 from an employee benefit plan governed by the Employee Retirement Income Security Act (ERISA).

The indictment, handed down by a grand jury in Houston on Oct. 18, charges Nickelson with willfully embezzling $485,000 from the plan for his use and that of others. He faces $10,000 in fines and five years imprisonment on each of the criminal counts under the provisions of 18 USC, Sec. 664. The plan covered as many as 12 participants and had approximately $1.2 million in assets as of May 1986.

In a separate civil complaint filed earlier by the Labor Department, Nickelson was alleged to have violated his fiduciary duties under ERISA by causing the plan to make numerous prohibited loans and transfers totalling $1,038,000 to benefit himself and Southwestern Rubber, a company solely owned by him. Also named in the civil case were the plan sponsor, Southwestern Rubber and Packing Company, and Jack Nickelson's son, Robert, a director of Southwestern.

The Labor Department complaint alleged that Jack Nickelson caused the plan to make the prohibited loans or transfers to himself and his son to pay his personal expenses and to finance corporate operations. The department's complaint also alleged that as a result of the improper transactions, he caused the plan to transfer nearly all of its assets to himself and his company in violation of ERISA's diversification requirement.

In addition, Nickelson is alleged to have failed to report the prohibited transactions on the plan's annual 5500 report filed with the Labor Department and to have attempted to conceal his illegal conduct.

Robert Nickelson is alleged to have been a knowing participant in the fiduciary breaches of his father by virtue of receiving a $100,000 loan from the plan which was ultimately transferred to the company.

The Labor Department complaint seeks a court order requiring the defendants to reimburse the plan for all losses and money improperly received by them. The complaint also asked the court to permanently enjoin Jack Nickelson from serving in a fiduciary capacity to any plan governed by ERISA and from violating provisions of ERISA in the future.

The civil complaint was filed on June 16, 1988 in federal district court in Houston. The court actions resulted from investigations conducted by the Dallas Area Office of the Labor Department's Pension and Welfare Benefits Administration. The criminal case is being prosecuted by the United States Attorney's Office in Houston and the civil case is being handled by the Labor Department's Office of the Solicitor in Washington, D.C.

# # # #

U.S. v. Nickelson

McLaughlin v. Nickelson
Civil Action No. H-88-2022

Mr. Keeney. In the latter case, I would say there is no such policy.

Mr. Anthony. There is no such policy?

Mr. Keeney. No.

Mr. Toner. I might add, Mr. Anthony, that restitution is not a legal defense to embezzlement.

Mr. Anthony. I understand that, but——

Mr. Toner. And there is case law in the ERISA area to that effect.

Mr. Anthony. We had an interesting case yesterday, though, that was brought to our attention that voluntary compliance was sought for a year and a half.

Restitution was finally made, and that seemed to be a determinant factor in not proceeding even with the civil case.

But Mr. Keeney, you made a comment earlier in your summary that really struck home to me, and maybe it's because of my past experience in the courtroom. And that is, you say sometimes a criminal conviction can help serve future cases by eliminating the ability of those people to engage in future conduct.

You take them out of the cycle, as it would be, and because of the prohibition, if they have a criminal conviction, if you do early—you know, I tell you what, if I were a defense lawyer and if I had a hold of one of those cases, the first thing I would do is go beat the door down at PWBA.

And I will say, I will save you guys a lot of trouble. I know you are short on staff, you don't have a lot of criminal investigators, and I know you have a lot of important cases. And besides, we didn't mean to create a lot of serious problems here. We just happened to borrow the money and spend it on ourselves. But we are willing to pay it back now, if you are wiling to do it on voluntary compliance, you know, we will save you a lot of trouble.

If they have a viewpoint over there to work it out that way than to even take a look at the hard way, a good, smart defendant and a good, smart defense lawyer can come in there and short circuit the system before it even gets a chance to operate.

And if I were a defense lawyer having watched these hearings and read the proceedings of these hearings, that is exactly what I would do in the next 6 months. I would go in there and try to short circuit the whole system because the system is set up to their benefit.

And you are basically saying, give us early referral. Give us early consultation, and if you don't get the early referral and early consultation, you end up with only the most grievous cases.

Mr. Keeney. That is right.

Mr. Anthony. And that is pretty clear what has come out of the testimony of people over at PWBA, is if they just get a case that just wreaks so badly, then they are going to rush out there and refers it to the Justice Department.

But if they get a case that they don't think reaches that policy goal, then they are going to find some other way to deal with it.

It appears to me that there is just a lot of good opportunities to short circuit that system and to take the criminal prosecution and the Justice Department right away from it.

And maybe that is what we are trying to struggle to find out if there is a better way to get that key coordination, and that key cooperation.

But if I understand you, and I hope I don't summarize incorrectly, you are not recommending any remedial legislation at this time to the Oversight Subcommittee, and you are saying that it can be handled with a change of attitude and a change of policy within the administration of the current situation.

Mr. **Keeney**. And some education, and we would have to be part——

Mr. **Anthony**. And some additional education, where you could help lend your expertise to those new staff people coming in.

Mr. **Keeney**. Yes, sir.

Mr. **Anthony**. Well, I think those are both very positive suggestions and comments, and I thank you for your testimony.

Mr. **Keeney**. Thank you, Mr. Anthony.

Mr. **Anthony**. Our next witness is James Lockhart, Executive Director of the Pension Benefit Guaranty Corporation.

Mr. Lockhart, your testimony is accepted for the record. You are welcome to proceed as you wish.

Yes, sir.

STATEMENT OF JAMES B. LOCKHART III, EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION, ACCOMPANIED BY CAROL FLOWE, GENERAL COUNSEL

Mr. **Lockhart**. Thank you for the opportunity to appear before you today to discuss the role and current financial condition of the Pension Benefit Guaranty Corporation.

I have with me our general counsel at the PBGC, Carol Flowe.

Our overriding goal is to keep the insurance program strong and healthy by reducing our losses and thereby our $1 billion deficit. Our loss prevention strategies are to encourage better funding of pension plans, to discourage the termination of underfunded plans, and to maximize recoveries when a plan is terminated.

Today, I will address our role in several specific enforcement areas, including standard terminations, funding and fiduciary breaches. Then I will update you on our insurance program and potential liabilities, including the critical LTV case. Last, I will review the program's problems that still remain after the major changes enacted in 1986 and 1987.

We take seriously our responsibility to protect participants when pension plans terminate with enough assets to cover all promised benefits. The 1986 changes made by Congress for processing standard plan terminations have produced a streamlined and effective program to handle 11,000 applications per year.

As required by law, we sample audit standard terminations to determine whether participants and beneficiaries have received their promised benefits. Where we have identified problems, plan administrators or plan sponsors have generally cured the problems. If necessary, PBGC will institute enforcement actions and coordinate with the Department of Labor as appropriate.

We are also concerned that the annuities distributed to participants when the plan closes out are safe. We believe that the statute is clear that the PBGC does not insure these annuities. The Department of Labor has stated that the selection of an insurer is a fiduciary responsibility subject to title I of ERISA.

We have begun a process of referring annuity purchases that raise possible fiduciary questions to the Department's Pension and Welfare Benefits Administration.

Enforcement of pension plan funding and fiduciary duties lies with the IRS and the Labor Department, but some of our activities reinforce them. First, the Pension Protection Act of 1987 created a lien in favor of the plan for missed contributions in excess of $1 million, effective for contributions due in 1989. We have perfected liens for a total of $17 million in two cases under this new provision. This provision also has been a valuable deterrent in several other cases. As part of this effort, the IRS has recently agreed to provide us with a listing of plans that have reported funding deficiencies in excess of $1 million.

Second, underfunded pension plans still pose a great risk to PBGC and participants. Accordingly, to inform participants and others about these funding gaps, we recently released a list of the 50 companies with the largest underfunded pension plans.

Third, legislation in 1986 and 1987 made the PBGC's role in the funding waiver process more explicit. It also tightened the standards for obtaining a waiver. Since then, the number of waivers has diminished and sponsors have provided the plans with better collateral.

In addition, for plans for which we are trustee, we take action to recover losses resulting from fiduciary breaches. Together with the Departments of Labor and Justice, we have pursued cases in which fiduciaries stole pension moneys, took large lump sum distributions from plans just prior to termination, failed to collect employer contributions, or invested funds imprudently. However, as Assistant Secretary David Ball stated in his testimony, fiduciary breaches represent a very small portion of our losses.

Secretary Dole's recent legislative initiative to strengthen enforcement and the President's request in the 1991 budget for additional enforcement positions to increase both criminal and civil investigations under ERISA should help reduce losses at the PBGC over the long term.

Now I will turn to our core role as the insurer of defined benefit plans. The private pension system is very healthy. Promised benefits are roughly $800 billion, but they are backed by over $1 trillion in pension assets. Some plans, however, continue to be underfunded.

The good news is that this underfunding is shrinking in both the multiemployer and the single-employer programs. The bad news is that some underfunded single-employer plans have sponsors that are in severe financial difficulty, and the plans are certain to terminate in the near term. These probable liabilities are booked annually by the PBGC.

In addition, continuing litigation with LTV could translate into a $1 to $2 billion net loss, depending on the Supreme Court's upcoming decision on restoration. The higher number could be reached if the recent Federal bankruptcy court recommendation in New York that eliminates our priorities in bankruptcy and our right to establish the pension liability under ERISA is upheld. This decision would have significant implications for the Eastern Airlines bankruptcy, where we are facing some $800 million in gross underfunding, as well as for many of our other cases.

Prior to this detrimental opinion, we reported in our 1989 annual report reasonably possible contingent losses of up to $4.5 billion, excluding LTV.

In 1989, we made significant progress as the combination of these premiums and strong investment returns reduced our deficit by $500 million to the present level, $1 billion. Should all break well—in LTV, Eastern, and other major cases—the agency could be solvent in a few years, as shown on the top line of the attached chart.

On the other hand, should we experience major losses, the agency could be some $8 billion in deficit, as shown on the bottom line. The middle line is a simple extrapolation of our average experience since 1982.

To protect the PBGC from the pessimistic scenario, we have used the legislative tools you have given us; joint and several liability, liens for missed contributions, the full claim for unfunded benefit liabilities, the variable rate premium, and stiffer termination tests. With these tools and our tough negotiating posture, we are implementing our three loss prevention strategies of encouraging better funding, discouraging underfunded terminations and increasing our recoveries.

Before discussing each of these strategies, I would like to note OMB Director Darman's 1991 Budget Introduction, in which he warned that the Federal Government must keep its contingent liabilities under continual review. Mr. Darman suggested insurance reforms as a way to address these hidden Pac Men and moral hazards. While the scope of further reforms for our program is still uncertain, I will identify some areas that may require future action.

In the funding area, most sponsors of defined benefit plans have strong tax incentives to anticipate their future liabilities, which typically leads to overfunding on a termination basis. These tax incentives, coupled with ERISA's diversification requirements and prudence rules, are the key reasons why we do not face the problems that have plagued the savings and loan industry.

In the area of underfunded plans, Congress has moved to strengthen funding rules. The tax barrier for large plans to be fully funded on a termination basis has been eliminated. The new lien and waiver rules are taking hold.

It is too early to assess the impact of the new minimum funding rules, but they still allow companies with underfunded plans to pay out more in benefits than they have contributed in that year.

To discourage terminations, we seek to limit them to situations in which the only alternative is the complete liquidation of the sponsoring firm as spelled out in the new distress standards. Nonetheless, we are faced with situations in which our only recourse is to seek an involuntary plan termination in order to limit our possible long-term losses.

This action can become necessary, for example, when one member of the controlled group is involved in a bankruptcy proceeding but the other members are not, such as in the Eastern Airlines situation. As our underfunding claim is only contingent, neither the plan nor the agency will collect any of this underfunding from the bankrupt's liquidation or restructuring. Similar problems occur when there is a break up of a controlled group. In order to keep the former controlled group members liable, we have to demonstrate that a principal purpose of the transaction was to evade termination liability. Because this standard can be difficult to litigate, we are reviewing some of these transactions to determine whether we need to protect ourselves by an involuntary plan termination. I believe we need to find solutions to these dilemmas, ones that would protect the agency and participants other than by the drastic step of involuntary plan termination.

Finally, we believe that we should only insure genuine plan terminations. A termination of an underfunded plan, coupled with a followon plan that restores the status quo, is an abuse of basic insurance principles. Should the Supreme Court rule against us in the pending LTV case with respect to our ability to prohibit abusive followon plans, we will need legislation to protect the program.

Historically, our losses have come almost exclusively from plans whose sponsors are in bankruptcy proceedings. Our priority claim for employer liability in these situations is typically limited to 30 percent of net worth, a number that is often quite low. Both the PBGC and plan participants would be better protected if all or a portion of the plan's underfunding was a priority claim, regardless of net worth. In any event, to remove the doubt presented by the New York bankruptcy judge, the law should be clarified that the PBGC's priority claim for employer liability has the status of a Federal tax claim.

Lastly, our losses increase dramatically in a plan with shutdown benefits when a plant shutdown occurs before termination. Unfunded shutdown benefits have caused $1 billion of our booked liabilities, one-fourth of our total. It may become necessary to explore how the agency can be better protected in shutdown situations.

I want to note one final area of possible legislative concern. Defined benefit plans and the insurance program may be more complicated than is necessary. This may be one reason why the portion of pension plan participants with primary defined benefit plans has fallen and our universe of covered plans is shrinking. I would hope that the three pension agencies could begin to work together with the Congress to reduce unnecessary complexity.

In conclusion, I want to assure you again that we are taking all possible steps to protect the PBGC and participants. However, as I have testified, the insurance program still has problems that may require further reform. The administration will review the issues I have raised here today with a view toward making recommendations early in the next session of Congress.

Thank you, Mr. Chairman, for the opportunity to testify. I would be happy to answer any questions you or the other subcommittee members may have.

[The prepared statement follows:]

TESTIMONY OF JAMES B. LOCKHART III
EXECUTIVE DIRECTOR
PENSION BENEFIT GUARANTY CORPORATION
HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT
JUNE 13, 1990

ADMINISTRATION AND ENFORCEMENT OF ERISA

Thank you, Mr. Chairman, for the opportunity to appear before your Subcommittee to discuss the role and current financial condition of the Pension Benefit Guaranty Corporation (PBGC). The PBGC is responsible for protecting the pension promises earned by American workers who participate in private-sector defined benefit pension plans. We administer two insurance programs that cover nearly 40 million people in some 100,000 pension plans.

The PBGC's overriding goal is to keep the insurance funds strong and healthy by reducing our current $1 billion deficit without increasing premiums. To do so we have to limit losses. We have three mutually reinforcing loss prevention strategies: to encourage better funding of pension plans, to discourage the termination of underfunded plans, and to maximize recoveries when a plan is terminated.

The PBGC's most visible enforcement effort is the one we have undertaken in the LTV case. Depending upon the Supreme Court's decision, we intend to continue using our authority to restore plans in appropriate cases, including where necessary to prevent abuse of the termination insurance program. A federal bankruptcy court in New York recently added even more importance to this issue by ruling against the PBGC on our bankruptcy priorities and our authority to determine the amount of underfunding for which the employer is liable. If allowed to stand, this ruling could be very detrimental to our insurance program.

Today I will first address PBGC's role in several specific enforcement areas including standard terminations, funding and fiduciary breaches. Then I will give you an update on our insurance program and potential liabilities. Lastly, despite the major and helpful changes that have been enacted in the past several years, the program still has problems. I will address these problems in the context of our three loss prevention strategies.

Enforcement for Standard Plan Terminations

PBGC takes seriously its responsibility to protect participants when pension plans terminate with enough assets to cover all promised benefits. The Single-Employer Pension Plan Amendments Act of 1986 (SEPPAA) changed the PBGC's role in processing these standard terminations. The changes made by Congress for processing standard plan terminations, including the certifications by the plan administrator and enrolled actuary and the right to bring an action to enforce violations of Title IV by private parties, have produced a streamlined and effective program.

Approximately 11,000 standard termination notices have been filed in each of the last three years. The PBGC is required by law to audit a statistically significant number of standard terminations annually to determine whether participants and beneficiaries have received the benefits to which they are entitled. For most of the terminations for which our audits identified problems, plan administrators or plan sponsors have voluntarily cured the problems. For those cases for which we are unable to obtain voluntary compliance, the PBGC will institute enforcement actions when appropriate. As part of this effort, we will coordinate with the Department of Labor when, for example, our audits identify possible breaches of fiduciary duty.

In addition to our regulatory interest in assuring that participants receive their proper benefits in a standard termination, we are also concerned that the annuities distributed to participants when the plan closes out are safe and sound. An issue that has recently emerged concerns the safety of these annuities, which are involved in about one-fourth of all standard terminations.

We believe that the statute is clear that the PBGC does not underwrite insurance company failure. The PBGC's insurable event for single-employer plans has always been the termination of a plan. The PBGC incurs a liability when a terminating plan has insufficient assets to provide guaranteed benefits. In contrast, if a plan terminates with sufficient assets to provide required benefits, the PBGC's involvement generally ceases.

As you know, the Department of Labor has opined that the selection of an insurer is a fiduciary responsibility subject to Title I of ERISA. We have begun a process of referring annuity purchases that raise possible fiduciary questions to the Department's Pension and Welfare Benefits Administration (PWBA).

Funding and Fiduciary Enforcement

The direct enforcement of pension plan funding or a plan sponsor's fiduciary responsibilities lies with the IRS and the Labor Department. However, the PBGC's activities reinforce those of the other ERISA agencies and involve close coordination.

In the funding area, the Pension Protection Act of 1987 (PPA) created a lien in favor of the plan for missed contributions in excess of $1 million. It first became effective for contributions due in 1989. The PBGC has perfected liens for a total of about $17 million in two cases under this new provision. In other cases, the lien served as a valuable deterrent when the parent of a bankrupt company decided to pay the full amount of required contributions to avoid the PBGC's perfecting its lien. Similarly, another sponsor elected to contribute sufficient funds to allow the plan to terminate in a standard termination to avoid the lien. As part of this effort, the IRS has recently agreed to provide us with a listing of plans that have reported to the IRS funding deficiencies in excess of $1 million.

While PPA did strengthen the minimum funding requirements, funding gaps persist. Chronically underfunded pension plans pose the greatest risk to PBGC. Not only does full funding help protect the PBGC, but it also helps assure that participants will collect their nonguaranteed benefits. Most plans, I am happy to note, are more than fully funded on a termination basis. Further, recent liberalizations in the deduction rules allow for greater funding of many of the plans that have been chronically underfunded. To more adequately inform participants and other interested parties about funding gaps, the PBGC recently released a list of the fifty companies with the largest underfunded pension plans.

For years we have been involved with the IRS in the funding waiver process. SEPPAA and PPA made the PBGC's role more explicit and tightened the standards for obtaining a waiver. Since these changes, the number of waivers has diminished and, where waivers have been granted, sponsors have been required to provide the plan with more and higher quality collateral. Not only do these tighter requirements protect the PBGC, they encourage sponsors to anticipate their funding requirements more realistically.

Lastly, in the area of prohibited transactions exemptions, we recognize that the Department of Labor's decisions regarding exemption applications must be made solely on the basis of the public record of the proceeding and are governed by clear statutory criteria. Within that framework, the PBGC has the opportunity to express its concerns and views. Our concerns are that the property have sufficient value and that the plan's interest be secured to the maximum extent possible in the event of any bankruptcy. We have never had a problem under this process.

For plans for which we are trustee, the PBGC routinely takes action to recover losses that plans have suffered as a result of fiduciary breaches. For example, the PBGC, in our role as trustee, together with the Departments of Labor and Justice, as appropriate, have pursued cases in which fiduciaries stole pension monies, took large lump sum distributions from plans just prior to termination, failed to collect employer contributions, or invested funds imprudently. However, as Assistant Secretary David Ball stated in his testimony, fiduciary breaches represent an insignificant portion of PBGC's losses.

Finally, in terms of enforcement actions generally, we believe that both criminal and civil sanctions are important in protecting both the PBGC and plan participants. Generally, when viewed solely in the context of limiting the PBGC's losses through increased recoveries, civil penalties have been more effective. Secretary Dole's recent legislative initiative to strengthen enforcement and the President's request in the 1991 Budget for additional enforcement positions to increase both criminal and civil investigations under ERISA should help reduce losses at the PBGC over the long term.

PBGC's Financial Condition

I would now like to turn to PBGC's core role as the insurer of defined benefit plans. The private pension system is very healthy and most of PBGC's risk is more than adequately covered by the assets in plan trusts. Overall, promised benefits are roughly $800 billion, but trust assets exceed $1 trillion. Some plans, however, are underfunded, in a few cases substantially so.

The good news is that this underfunding is diminishing. Underfunding in the multiemployer program has been reduced from approximately $14.5 billion in 1980 to an estimated $5.5 billion currently. A large part of this reduction is attributable to the Multiemployer Pension Plan Amendments Act of 1980.

In the single-employer program, underfunding also has declined, thanks in no small part to the strong stock and bond markets in the 1980's. In the single-employer program, we can identify about $16 billion of known underfunding, compared to about $24 billion in 1980. I should also note that much of the single-employer exposure is implicitly backed by the corporate worth of the sponsors, most of whom are in good financial condition.

The bad news is that some of the underfunding in single-employer plans is associated with sponsors that are either in bankruptcy or are likely candidates for a filing. Some of these plans are certain to terminate in the very near term. In the language of the Financial Accounting Standards Board, these are called "probable" liabilities and, accordingly, are booked by the PBGC.

In addition, the PBGC's continuing litigation with LTV could translate into a potential $1 billion to $2 billion net loss to the PBGC, depending on the Supreme Court's upcoming decision on restoration, as well as on the resolution of the recent federal bankruptcy court decision in New York that adversely affects our claims. This bankruptcy court decision also could have significant implications for the Eastern Airlines bankruptcy, where we are facing some $800 million in gross underfunding, as well as for many of our other cases. Excluding LTV but including Eastern, we reported in our 1989 Annual Report "reasonably possible" contingent losses of up to $4.5 billion.

Offsetting this bad news are the PBGC's increased premium income and increased investment returns. Recently legislated premium changes mean that PBGC's premium income is now over $600 million a year. That change, combined with strong investment returns in 1989, resulted in a profit and commensurate reduction of PBGC's deficit by about $500 million, to its current level of $1 billion.

Should all break well -- in LTV, Eastern, and several other major cases -- the agency could be solvent in a few years. That scenario is represented by the top line on the attached chart. On the other hand, should we experience major losses in those cases, the agency could be some $7.8 billion in deficit; that future is represented by the bottom line on the chart. The middle line is a simple extrapolation of our average experience since 1982.

Our three loss prevention strategies -- to encourage better funding, discourage underfunded terminations and increase our recoveries -- are designed to prevent the most pessimistic scenario. To implement these strategies and protect the PBGC, we have used the legislative tools you have given us, such as joint and several liability, liens for missed contributions, the full claim for unfunded benefit liabilities, the variable rate premium, and stiffer termination tests, combined with a tough negotiation posture.

Before discussing each of these strategies, I would like to note OMB Director Darman's 1991 Budget Introduction, in which he warned that the Federal government must keep its contingent liabilities under continual review. Recent hearings before this Subcommittee already have highlighted issues among the various government-sponsored credit programs.

The moral hazards inherent in Federal insurance programs, such as the PBGC, also have to be carefully monitored. Mr. Darman suggested "insurance reforms" as a way to address these "hidden PACMEN" and reduce growth in the Federal government's contingent liabilities. While the scope of further reforms for the PBGC programs is still uncertain, I will identify some areas that may require future action.

Encouraging Better Funding

Fortunately, most sponsors of defined benefit plans have strong tax incentives to anticipate their future liabilities. This typically leads to overfunding on a termination basis and thus greatly limits PBGC's exposure. These tax incentives, coupled with the diversification requirements and prudence rules of Title I of ERISA, are the key reasons why the PBGC does not face the magnitude of countervailing incentives that have plagued the savings and loan industry.

Changes in the tax laws over the past decade, however, have diminished the incentives to fund plans in ways that anticipate projected liabilities. Though the remaining incentives are adequate to protect the PBGC, I am concerned that further changes reducing these incentives -- such as the provisions of S.685 that put severe limits on reversions -- would have the unfortunate by-product of increasing risks to the pension insurance program.

In the area of underfunded plans, Congress has moved to strengthen funding rules and to tighten the waiver process. Recent liberalization in the deduction rules have eliminated any significant tax barrier to being fully funded on a termination basis, at least for large plans. As I discussed earlier, the new lien and waiver rules seem to be taking hold. It is just too early to assess the impact of the new minimum funding rules in PPA. Accordingly, it is not clear whether the rules are adequate for severely underfunded plans. For example, the new rules still allow companies with underfunded plans to pay out more in benefits than they have to contribute to those plans in the same year.

Discouraging Termination of Underfunded Plans

In general the PBGC seeks to limit terminations of underfunded plans to only those situations in which the only alternative is the complete liquidation of the sponsoring firm. The new distress standards have helped to clarify and limit PBGC's insurable event. Nonetheless, the PBGC is still faced with situations in which, in order to limit our possible long term losses, our only recourse is to seek an involuntary plan termination.

This action can become necessary, for example, when one member of the controlled group is involved in a bankruptcy proceeding but the other members are not, such as in the Eastern Airlines situation. Without terminating the plan, the PBGC's underfunding claim is only contingent, and neither the plan nor PBGC will collect any of this underfunding from the bankrupt's liquidation or restructuring. I believe we need to find a solution to this dilemma; one which would protect the PBGC and participants other than by the drastic step of involuntary plan termination.

Similar problems occur when there is a break-up of a controlled group and an underfunded pension plan is either transferred to or remains with the financially weaker controlled group members. If these financially weaker subsidiaries subsequently qualify for a distress termination, the former controlled group members may not be liable under current law unless the PBGC can demonstrate that a principal purpose of the transaction was to evade termination liability. Because this standard can be difficult and time-consuming to litigate, the PBGC is forced to review some of these commercial transactions, if known prior to completion, to determine whether we need to protect ourselves by an involuntary plan termination. Again, if some less disruptive solution to the dilemma could be developed, it would be helpful.

Finally, the PBGC continues to believe that it exists only to insure against genuine plan terminations. A termination of an underfunded plan, coupled with a follow-on plan that restores the status quo ante, is an abuse of the basic insurance principles undergirding the program. Should the Supreme Court rule against us in the pending LTV case with respect to our ability to prohibit abusive follow-on plans, we will need legislation to protect the program.

Increasing the PBGC's Recoveries

Historically, the PBGC's losses have come almost exclusively from plans whose sponsors are in bankruptcy proceedings. The PBGC's priority claim for employer liability in these situations is typically limited to 30 percent of net worth, a number that is often quite low. Both the PBGC and plan participants would be better protected if all or a portion of the plan's underfunding was a priority claim, regardless of net worth. In any event, the law should be clarified to remove any possible doubt that the PBGC's priority claim for employer liability always has the status of a Federal tax claim. The recent recommended decision of the bankruptcy court in the LTV case denying that the PBGC's claims are entitled to tax or administrative priority status casts a very large cloud on the financial soundness of PBGC's insurance programs. For this and other reasons, we intend to appeal this decision vigorously.

Another problem that arises in bankruptcy is that the PBGC often does not get the information that other creditors receive. A possible remedy would be to authorize the PBGC to be a member of the creditors' committee in any bankruptcy case involving an underfunded pension plan.

Lastly, the PBGC's losses increase dramatically in a plan with shutdown benefits when a plant shutdown occurs before termination. The loss occurs because the PBGC guarantees certain shutdown benefits, which are early retirement benefits that become payable when a plant or facility is closed down.
These benefits are usually subsidized, and they are not generally pre-funded. Indeed, $1 billion of PBGC's booked liabilities -- one-fourth of our total -- can be traced to unfunded shutdown benefits. It may become necessary to explore how the PBGC can be better protected in shutdown situations.

Simplification

I want to note one final area of possible legislative concern. Defined benefit plans and the insurance program may be more complicated than is necessary to accomplish the basic underlying social objectives. This may be one reason why the portion of pension plan participants covered primarily by a defined benefit plan has fallen, and our universe of covered plans is shrinking. I would hope that the three pension agencies could begin to work together with the Congress to reduce unnecessary complexity. Some of the areas the PBGC is considering for simplification are the several interest rates used and the rules for determining guaranteed benefits.

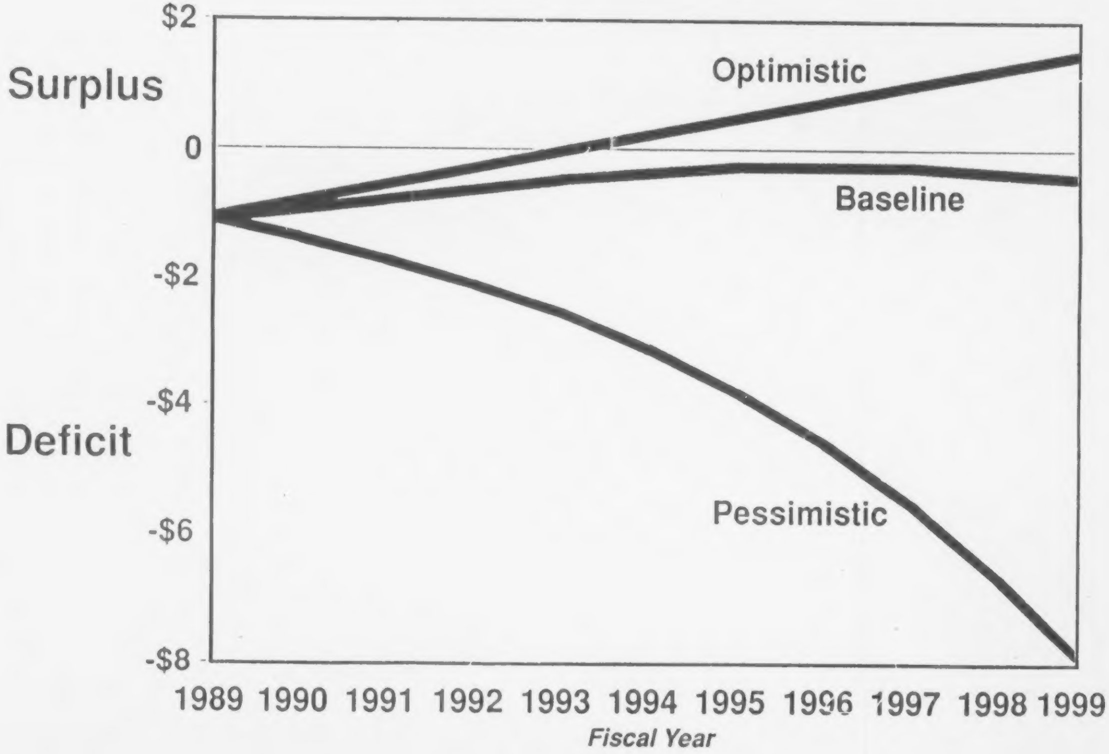
Conclusion

In conclusion, I want to assure you again that we are taking all possible steps to protect the PBGC and participants. However, as I have testified, the insurance program still has problems that may require further reform. The Administration will review the issues I have raised here today with a view towards making recommendations early in the next session of Congress.

Thank you, Mr. Chairman, for the opportunity to testify here today. I would be happy to answer any questions you or the other Subcommittee members may have.

PBGC's 10-Year Forecast

(Dollars in billions)



Mr. **Anthony**. Thank you, Mr. Lockhart.

Ms. Flowe, as I understand it, you are General Counsel.

Ms. **Flowe**. That is correct, Mr. Anthony.

Mr. **Anthony**. All right. Thank you.

In terms of your last comment, Mr. Lockhart, about the complexity and the fact that with plan cancellations and the slowdown in plan implementations you are in a very disturbing trend out there, I know that my colleague from the State of Washington, Mr. Rod Chandler, has been working on that.

I have also been working with some outside groups to try to pinpoint some areas of concern, and I think we have now pinpointed over 20 specific areas where we could make those as a recommendation to the full committee, should there be a tax vehicle later this year that would not change the public policy but would make it easier for the plan coordinators to do what the statutes and the regulations requirement.

So hopefully, we will be successful in that regard, and maybe we can help remedy some of the complicated parts of the law.

It's sad that the numbers are going down. It's obviously something that we need to take and move the numbers up.

The bankruptcy of sponsoring employers, although it's not necessarily the topic of this particular hearing, I think you have highlighted a very, very serious legislative problem that needs to be addressed without question, and it appears that that is where you are being caused undue hardship.

And we do anxiously await the Supreme Court's decision, and if that decision is adverse, I think you will find that you have an awful lot of allies in the Congress that will try to move very expeditiously to try to straighten out that situation.

We are here, though, to try to find out if the administrative policy is a proper policy or whether or not it needs to be revised in terms of civil activity and criminal activity.

Yesterday we had a particularly egregious fraud case referred to as the Lundberg case which resulted in several years of imprisonment for the participants in that particular fraudulent scheme. We were told that you were the first Federal agency to be informed of potential problems with those plans, and I guess what I would like to find out from you, when were you informed and by whom, and what did you do with that information, and was there time to save any of the pension's assets at that particular point?

Mr. **Lockhart**. We were informed by participants who called us—they were concerned—and also by congressional offices. It was about at the same time as everybody else was getting the calls. It was in the end I think of July 1987.

At that point, there were not any assets left, and by the time we terminated the plan, there were no assets—but we did make recoveries of approximately $4½ million, so our net loss in that case was about $3½ million.

And the recoveries came from the purchaser, the new purchaser of Lundberg Industries.

Mr. **Anthony**. Part of the scheme to embezzle these funds was to terminate. The plans then take reversion of some $3 million in excess assets.

Were there any forms filed by any of the parties responsible in the Lundberg situation with the PBGC in the course of implementing that scheme?

Mr. LOCKHART. Yes, there were.

In December of 1986 they filed a standard form for a standard termination.

Mr. ANTHONY. Who would be responsible for reviewing those forms?

Mr. LOCKHART. We review them in the agency. It's one of our functions. We look at the certifications, and there was certification from an actuary and the plan administrator, and the paperwork was in order.

Mr. ANTHONY. In other words, the forms were filed, the forms were reviewed by personnel in your organization, qualified personnel who knew what to look for to ascertain whether or not there was any unusual activity.

Mr. LOCKHART. Right.

Mr. ANTHONY. And came to the conclusion that on the surface, on the face of those instruments, that everything was OK?

Mr. LOCKHART. Right, exactly. I mean, they lied on the form, and it's very hard to tell if someone is lying when they sign a piece of paper, and that is effectively what happened in this case.

Mr. ANTHONY. So actually, other than forcing everybody to be truthful, then there is no way we can revise the form and there is no way anybody at your agency could have detected, had an early warning signal that there was some fraudulent activities?

Mr. LOCKHART. An enrolled actuary's certificate is supposed to be the catch. There are supposed to be two signatures, the administrator and an independent actuary.

Mr. ANTHONY. Were they both there in this case?

Mr. LOCKHART. Both of them signed the form, yes, sir.

Mr. ANTHONY. So if you just got out right—and both were convicted, as I understand?

Mr. LOCKHART. Yes.

Mr. ANTHONY. But if you have reached a collusion at that point, then something else within the system has to be responsible for detecting the criminal activity, other than your organization?

Mr. LOCKHART. That is the start of the process. That was the application to do the standard termination.

We never got the second piece of paper, which was the certificate, the termination that actually happened, because we found out information before then.

We started to get calls from people that knew that the plan had taken the reversion, and they hadn't gotten their annuities yet. And that is normally how we would find out in a situation, participants call up with a problem.

Mr. ANTHONY. In this case, the PBGC pursued an independent civil case under Lundberg at the same time the PWBA was pursuing their civil case.

Why did that occur?

Mr. LOCKHART. We were coordinating and we were working on it. We were suing, as a trustee, to recover the assets for the plan.

PBGC was suing on the basis of fiduciary breaches. And also in their civil case, I think they have some authorities, for instance, that they can ban an actuary from practicing for a long time as a fiduciary.

So that they have different cases. I mean, we were suing primarily just as a trustee to recover the assets.

Mr. ANTHONY. Would you not have the authority civilly to pursue every civil remedy that would have been in the other civil case? Does general counsel want to answer that?

Ms. FLOWE. No, Mr. Anthony, we don't actually. We do have the authority to collect any losses to the plan in such a civil action.

What we don't have that PWBA does have is the ability to get an injunction against a wrongdoer from ever serving again in a fiduciary capacity.

That was one of the reasons that it was important for PWBA to also bring suit in this case.

Mr. ANTHONY. I understand that. Well, as general counsel for PBGC, would you like to have that authority extended to you?

Ms. FLOWE. I think that the system as it is works well. We, really as I think Mr. Lockhart testified, very little of our underfunding involves this kind of fiduciary breach actions.

Mr. ANTHONY. So, what bothers me about it, Ms. Flowe, is it took two different agencies, two sets of lawyers, two different sets of civil documents, complaints to be drafted to be served, to be processed, and two different sets of probably— don't know in this case; you might have had the same defense lawyers working on the cases.

But it appears to me that that is a waste or at least a pressure on resources where it takes two different Federal agencies to file two separate civil cases in order to get your total civil remedy.

At first blush, that appears to me to be a fairly inefficient way to proceed. It seems to me that if one agency had all of the civil remedies, then that would have been the agency that should have moved forward for the benefit of all parties. But yet you say you like the system as it operates.

Ms. FLOWE. Well, in that respect, this case was probably somewhat unusual. Typically in a case where the plan is terminated, we bring the action, in consultation with PWBA, but they wouldn't have also brought an action.

If it's an ongoing plan situation, PWBA brings the action and we have no authority to bring an action, so this one, because of the egregious nature of the violations, was a somewhat unusual case. But we don't see too many of those, and I will also add that because of the very close cooperation between my office and the solicitor's office that was doing it for PWBA, there was really relatively little duplication of effort.

And since that time, the actions filed by each of us have, in fact, been consolidated. So it's really one consolidated action.

Mr. ANTHONY. Thank you. My time has expired.

Mr. Chandler.

Mr. CHANDLER. Thank you, Mr. Chairman.

Mr. Lockhart, I believe that a point you make here concerning the shutdown benefits is an important one. I would like to review that a little more for the record.

I know this was an issue the committee faced. I have forgotten when we last raised the PBGC premium.

Mr. **Lockhart**. 1987.

Mr. **Chandler**. 1987. At that time, I believe we even considered not covering or no longer covering by PBGC the shutdown benefit.

What has happened since 1987 with regard to your liability and losses accrued by PBGC as a result of the payment of shutdown benefits?

Maybe, for the benefit of the other members of the committee, you could enlighten us all on exactly what those benefits are. Are they prefunded; and if not, why not and so forth?

Mr. **Lockhart**. Shutdown benefits tend to be in unionized plans and heavy industry, and the idea is that workers get early retirement if a factory is shut down. The problem is that the actuaries say that shutdown benefits cannot be prefunded because you cannot actuarially predict when a factory is going to be shut down.

As a result, these tend to spring in and they tend to be big benefits, and they tend to spring in right before a company gets into trouble.

It starts to shut down a few factories, and then all of a sudden, it goes into chapter 11. And in the meantime, its liabilities have blossomed right before termination.

The numbers, as I pointed out in my testimony, have been very large historically at the agency. Over the last 2 or 3 years, losses overall at the agency have been reasonably well under control, and part of that is because of the legislative changes in 1987 and 1986.

What we are seeing is fewer losses, but we don't know at this point whether we are just pushing them out to the future because of the stricter distress test or whether we are actually seeing a permanent diminution.

We are certainly dealing with a lot at the moment, with a lot of big plans. LTV and Eastern obviously are two examples. So there is no indication that we are going to see a permanent downshifting in our losses.

In the shutdown benefits area, because of the improvement in the steel industry primarily, we have not seen as many steel industry companies lately. We have two or three smaller ones at the moment that could possibly get into the shutdown benefit area, but at the moment, we don't have any significant ones.

Mr. **Chandler**. All right.

Thank you. In a situation where the shutdown benefit issue is not involved and a company begins, because of financial difficulties, to underfund its pension plan, and let's assume further that over a span of a number of years, perhaps 10, not only is the company in trouble but it is underfunding its pension plan, and eventually ends up in bankruptcy and PBGC accepts the liability, at what point do you, as an agency, become involved when are you informed about this growing liability?

And is there any need for reform here so that we could, perhaps, pull a trigger that says we are not going to accrue any more benefits in this troubled, underfunded pension plan because of this growing liability? Could you comment on this?

Mr. **Lockhart**. Yes. You put your finger on the right problem here, and in the PBGC, our problem is not fraud. Our problem is large underfunded plans that have continuously, since the birth of ERISA, been underfunded, and we know them.

They do not change very much year to year. We recently put out the list of 50 companies with the largest underfunded pension plans. We are dealing with the troubled ones on that top 50 list on a very regular basis already, many of which we may not actually ever terminate, maybe 2 or 3 years down the road or never, so we are getting involved, discussing funding with management.

We also get very involved in the waiver process. When any of these big companies come into IRS to ask for a waiver, we are always there at the table.

We always participate with the IRS in the process, and if a waiver is granted which thankfully now is very rarely, we get involved very much in the collateral that is being given and make sure that it's adequate to cover the risk of the underfunding.

So overall, we are getting actively involved. The problem is, and you pointed out there, we don't have a lot of tools to use, at that point in the process. As long as a company is making its minimum funding contributions, there's not much we can use except moral persuasion.

Mr. CHANDLER. Now, when you say "minimum funding contributions," still underfunded, still representing a liability, and a risk for PBGC but nevertheless able to slide along to the next year, would you also find because workers are continuing to be covered by the plan that your liability would actually grow under a minimum funding scenario?

Mr. LOCKHART. That can certainly happen, and it has happened in many cases. There is one example. One of the four LTV plans that was terminated was making all its minimum funding contributions and actually ran out of cash because it was a combination of increasing benefits and making lump sum distributions.

And we had to take over a $200 million-plus liability with a plan that was making its minimum funding contributions.

Mr. CHANDLER. Well, do we need to give you a tool, do you think, at some point in this process to say, hold it, we are not going to terminate the plan. We are not going to force anybody into bankruptcy, but we are also not going to promise any more benefits until this situation is rectified?

Mr. LOCKHART. That is an idea worth considering. We will look at that idea as part of the proposals we are considering for next year.

Mr. CHANDLER. It seems to me, Mr. Chairman, if something like that had been done in the 1970's in the savings and loan situation, perhaps we would have avoided some of what we are in now.

It's easy to bring Mr. Lockhart in and beat him up for the red line scenario, but if he doesn't have any way to stop that read ink from accumulating, how can we blame him?

Back to the question of the 50, the top 50 that you listed, one of which is headquartered in my district, has a green tree emblem. Remember those?

Mr. LOCKHART. Yes.

Mr. CHANDLER. They argue to me that they are in great shape, and they responded, of course, that they are not fully funded. They are on the list, but what is the difference between a company like that with enormous assets and I would say minimal risk to PBGC and the others on the list?

Mr. LOCKHART. The list we decided to put out did not have a risk factor on it. It was just a list of the underfunding and corporate pension plans based on the PBGC interest rate.

We only looked at the underfunded plans because, from our standpoint, we have to look at a plan-by-plan basis. And if a company, for some reason, I am sure the Weyerhaeuser Co. would not be one, went into bankruptcy, we have to look at an individual plan-by-plan basis of the underfunding.

We would take over the underfunded plans, and we would not have any claim to the overfunded plans. So what we were looking at on this list is just underfunded plans based on the PBGC interest rate as a way to highlight the issue.

We only used public disclosure information, SEC filings. In a couple cases, that meant that we picked up some nonguaranteed plans.

The next time we do the list, we will certainly take out the nonguaranteed plans, but the purpose of the list, and I think it did serve the purpose, was to highlight the underfunding issue.

From my standpoint, and because we don't have the tools you were just mentioning, one of the ways that we can highlight this issue is to show the issue out front and show people where the underfunded plans are.

Many of the companies on the list, which we stated in our press release, do not have financial difficulties, and there is no indication that they will.

On the other hand, there are many companies on that list that we are dealing with right now and close to a termination basis.

Mr. CHANDLER. All right.

Mr. Chairman, thank you.

Mr. ANTHONY. Mr. Pickle.

Chairman PICKLE. Mr. Lockhart, have any significant number of claims been made against PBGC as a result of criminal misconduct?

Mr. LOCKHART. According to our records, the biggest claim so far has been the Lundberg case that you talked about yesterday. We have one right now, another one that has not been trusteed that's slightly bigger than the Lundberg case. And beyond that, we don't know of any over $1 million.

From our standpoint, fraud is not the problem at the PBGC. It's this chronic underfunding problem.

Chairman PICKLE. All right. So then it's a small number of cases.

Mr. LOCKHART. It's a small number of cases.

Chairman PICKLE. Which have made claims against the PBGC?

Mr. LOCKHART. Right.

Chairman PICKLE. All right.

If we are going to lose considerable moneys from the two cases pending in the court now, the LTV and Eastern, in the event the Supreme Court rules against the PBGC or the Government in these cases, do you plan to come before this committee or before the Congress to ask for legislation?

Mr. LOCKHART. Yes, sir. We do plan to do that. What we need from our standpoint is—and 1986 and 1987 was a good start in the direction—to create an insurance system that gives the incentives to the sponsors to make the contributions rather than terminate their plans. And that is what the gist of our proposals will be. We will be looking at the bankruptcy priority issue and the controlled group issue. If we lose the LTV case, we will consider the followon plan issue which gives us some coinsurance. We will look at the funding rules again, and also the shutdown benefits issues. Those are the big issues that we see that need some fixing for PBGC to become what I would call a sound insurance program.

Chairman PICKLE. How much would we lose—how much do you estimate we might lose if there is a continuing series of bankruptcies, not just S&L, but business in general because the trend seems to be increasing?

What is our potential loss if that trend continues?

Mr. LOCKHART. The pessimistic case there, through 1999 is an $8 billion deficit. That is not our worse case scenario. That's a pessimistic case scenario.

One can paint a much worse case if the recent Judge Lifland New York Bankruptcy Court opinion is upheld and we lose the LTV case.

That court opinion eliminated our priorities in bankruptcy effectively, or made that recommendation to the district judge, and it also suggested the bankruptcy judge had a right to set the interest rate to discount the pension fund.

One could see a bankruptcy judge choosing a very aggressive interest rate that could even eliminate our claims in some cases. We would be taking billion dollar hits and yet we would have no claims in bankruptcy.

So those kinds of scenarios could even get worse than that $8 billion.

Chairman PICKLE. You said in the past the most serious problem we have at the PBGC is the financial failure of the plan sponsor, rather than fraud or criminal activity.

Do you, as an organization, PBGC, monitor these plans that may be in difficulty when the reports are made, do you monitor them all along?

Mr. LOCKHART. Yes, Mr. Chairman, we do. As I said in my testimony, a group of probable losses that we have actually already booked.

Those we are monitoring on a very, very active basis. The next category of companies are reasonably possible losses, and we monitor them as well. And we have teams assigned, including an attorney, financial analyst, and an actuary is necessary to monitor these individual companies so that we are not surprised.

Chairman PICKLE. Do you bring that to the attention of the PWBA or to the IRS?

Mr. LOCKHART. We would talk about it with the IRS if the company came in with a waiver, but we do not give the list to the IRS or the PWBA at this point.

Chairman PICKLE. You monitor it, but you don't really pass that information on to anybody?

Mr. LOCKHART. Except in the case of waiver requests which, in fact, tend to be the biggest cases and the ones that are about ready to happen.

Chairman PICKLE. Of these probable liability cases, probable liability because of the unfunded activities or because of bankruptcies, can you estimate the potential loss to the fund?

Mr. LOCKHART. Well, the probable ones we have already booked, and as of year end 1989, we had about a quarter of a billion dollars in probable losses.

In addition, the reasonably possible ones, the category for which there is some reasonable chance that within the next couple years we will have to take over the pension plans, gets to be a number of about $4.5 billion.

Now, we are working with these companies and trying to encourage them to fund the pensions and trying to use the tools that you have given us so that they don't become losses. And one of the key efforts we really have at the agency is negotiating with these companies to try to make sure that they don't become losses.

Chairman PICKLE. If you have about a $5 billion potential loss, is that in addition to the estimated loss because of the cases pending, or is that total?

Mr. LOCKHART. The $5 billion does not include LTV, but it does include Eastern Airlines, so if you put in LTV and we lost LTV at the Supreme Court and the bankruptcy judge's opinion was upheld, that could be another $2 billion.

Chairman PICKLE. All right.

Mr. ANTHONY. Thank you very much for your testimony.

Chairman PICKLE. The last panel consists of David Walker, David Davis, Chester Salkind, and August Lauer.

Mr. Hoffman is our friend representing the CPA organization. We are glad to have you with us again, Mr. Hoffman. He is chairman of the Federal Taxation Executive Committee of the AICPA.

David Davis is the assistant general counsel for personnel and labor relations for General Motors Corp., and he will be representing the ERISA Committee Industry as a whole.

Then we have Chester Salkind, executive director of the American Society of Pension Actuaries.

And we have August Lauer, the senior manager of the employee benefits for Federal Express Corp. out of Memphis, and he represents the Association of Private Pension and Welfare Plans.

We will proceed, then, in that order.

Mr. Hoffman, if you will proceed first.

Before you start, let me say to you, I appreciate you people being patient, staying with us all day, for the most part, and it's been a long hearing, but we are putting information on record, and I know that you want to make statements that will be invaluable to the hearing.

We wanted to be sure that we got on the record some of your concerns, and we have asked you to move it up one day so we wouldn't have a 3-day hearing.

So I appreciate all of your cooperation.

Mr. Hoffman, if you will go ahead.

STATEMENT OF ARTHUR S. HOFFMAN, CHAIRMAN, FEDERAL TAXATION EXECUTIVE COMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, ACCOMPANIED BY DAVID M. WALKER, MEMBER, EMPLOYEE BENEFIT PLANS COMMITTEE

Mr. **Hoffman**. Mr. Chairman, I am Arthur Hoffman, chairman of the executive committee of the Federal tax division, as you introduced me before.

We gather here today in a very noble cause. Secretary of Labor Elizabeth Dole captured its essence in a recent speech. Referring to pension security, she said,

> We will strive to ensure that every participant receives the benefits to which he or she is entitled.

Her message, I am sure, would be seconded by every one of us, and most certainly by the members of the AICPA. Her goal is important to the vigor of both our economic and democratic systems.

We do appreciate the importance of our role as CPA's. To illustrate the point, I quote again from Secretary Dole's speech. She said,

> We have been working closely with the American Institute of Certified Public Accountants on all audit-related issues, including compliance testing. I am pleased to report that our negotiations with the AICPA on this matter are progressing constructively.

There are two critical areas of inquiry in determining whether Congress and the regulatory agencies have done everything possible to accomplish our common goals, the adequacy of the rules, including the penalty provisions, and the clarity of disclosure provided by the reports.

As to the enforcement rules, if you examine the rules objectively, you must conclude that they are potentially a potent array of weapons to safeguard the retirement benefits of the American worker. The simple fact is that the fiduciary who violates those rules imperils both his personal wealth and, indeed, his freedom.

The fiduciary is personally liable for breach of duty and for restoration of profits if he has used the plan assets to personal advantage.

The ERISA rules and the DOL and Treasury regulations and case law fill in a mass of details. The penalties for transgressions are high, and they are comprehensive.

Prohibited transactions are a target as they should be. There are civil and in some instances criminal penalties for all sorts of things: a failure to provide information to DOL and the IRS and participants; late filings; engaging in prohibited transactions, and providing false statements; failing to meet minimum funding requirements; preparing deficient tax returns; and reverting of excess assets to the employer.

In addition, a plan could be denied qualification or disqualified by the IRS for not operating exclusively for benefit of the employees.

We referred to these rules as potentially a potent array of weapons. We say "potential" because they are hollow promises to American workers in the absence of aggressive enforcement. We will cover this point in a moment when we offer our recommendations.

With respect to the reports, the DOL and Pension Benefit Guaranty Corporation receive annual reports, and the IRS receives annual returns from plan administrators.

Now, an enormous amount of information is currently provided in the annual returns and reports. You heard about the change in the form 5500 starting in the 1988 year. If somehow they are still deficient, if they are not flagging the issues that deserve scrutiny, they must be redesigned or supplemented. I will cover this, too, in our recommendations.

On our recommendations as to penalties, I briefly described the array of penalties available to the IRS and the DOL and the PBGC to deter and to punish those who abuse their fiduciary position. It is tempting to add another layer of penalties or make them more severe. That was the pattern prevailing before 1989 when you, Mr. Chairman, initiated penalty reform. The penalty rules had become unadministerable because each newly perceived abuse over the years was met with a newly devised penalty. We recommend that the pattern not be revived. The penalties now are intimidating enough. It is enforcement which must be intensified.

Chairman PICKLE. Mr. Hoffman, I will interrupt you to tell you that we appreciate the cooperation of the CPA in that civil tax penalty approach. I think the committee put together a good recommendation and passed a good law, and we are proud of our work and proud of your cooperation as an organization.

I noticed you took note of that recently in the national magazine, but it is that kind of cooperation between Government and industry that makes us move forward and make improvements, so I appreciate your work and cooperation.

Mr. HOFFMAN. Mr. Chairman, I don't know if you saw the particular magazine that I have here with me. It is the CPA Journal, which is the New York State Society's magazine, and it has a picture on the cover of yourself.

Chairman PICKLE. Would you hold that up. I can't see it. The other way. The camera is over this way. That's it. I recognize that.

Mr. HOFFMAN. It has a caption on it saying, Congress at its best, IRS penalty reform, and your picture.

Chairman PICKLE. Thank you, Mr. Hoffman.

Mr. HOFFMAN. With respect to—I hate to go on with another subject——With respect to the reports, earlier we stated that the currently required reports contain an enormous amount of information. However, they may not be adequately detailed and revealing.

The IRS and DOL must be put on clear notice of acts which might deplete plan assets so that they can act quickly to stop the hemorrhaging.

We recommend that the returns and the reports be carefully analyzed for the adequacy of their disclosure by experts in the fields of pension plan administration, fiduciary legal responsibilities, accounting, et cetera. These experts should be gathered from the IRS, the DOL, and professional firms. Proposals to modify or supplement the returns and reports should be implemented promptly.

With respect to setting standards, we have certain recommendations. We call your attention to a section of the excellent report of the staff of the Joint Committee on the subject of your hearing captioned "Purchase of Annuities by Pension Plans."

The section states, and it has been cited today,

> There has also been recent concern regarding the solvency of insurance companies from which commercial annuities are purchased by retirement plans * * * While the choice of an insurance company is a fiduciary decision under ERISA * * *, ERISA does not contain specific guidelines regarding the purchase of such annuities. The PWBA and the PBGC have indicated that they intend to take appropriate action to address this issue."

Mr. Chairman, CPA's can cooperate with the IRS and DOL in devising the most complete and detailed returns and reports. We can prepare them with total dedication to complete disclosure. But the agencies must decide what is prejudicial to the interests of the American worker in order to perform a purposeful review of those returns and reports.

In this case, and in many others, the ERISA rules and case law interpretations could readily serve as the basis for guidelines for the enforcement of agencies to prevent abuse.

The AICPA recommends that the drafting of such guidelines be given the highest priority.

On IRS and DOL resources and funding, we have stated that the rules, in theory, do protect the interests of the American worker. Vigorous enforcement of those rules is the key to turning that theory into reality. We recommend that Congress be receptive to requests from the IRS and DOL to enhance their capability to insightfully review returns and reports and to quickly send out well-trained experts in appropriate circumstances.

We have a recommendation with respect to roundtable discussion, Mr. Chairman. You personally have elevated the legislative and regulatory process in the past by calling for roundtable discussions to develop a consensus and broad support for the proposal. That method would be ideal to address the subject of today's hearing, how best to report and review transactions for compliance with ERISA. The goal to ensure that every participant receives the benefits to which he or she is entitled is shared by all parties.

Since there is no lack of rules, the process of refining them can best be accomplished with input from experts in various professional disciplines.

Mr. Chairman, I have one final point to make before I yield to Mr. Walker. It is a subject of prior witnesses and Mr. Schulze, Mr. Chandler, and Mr. Anthony. The subject is simplification.

The AICPA fears that the complexity of the rules governing pension plans is discouraging companies from adopting plans or maintaining them. We are seeing too many terminations and freezes and lack of enthusiasm to commence plans, especially among small and medium-sized businesses. It is one thing for us to meet today to see how we can preserve the benefits already promised to the American worker, but many will suffer hardship in retirement if companies lose interest in providing benefits out of fear of governmental regulatory quagmires.

Chairman Rostenkowski wisely requested interested parties to submit proposals to simplify any and all aspects of the tax law. The AICPA did so on April 20 when he asked for them, and a key section of our recommendation was on pension and profitsharing plans.

We have taken the liberty of appending that section to our written testimony. It contains 27 different recommendations. We believe that simplification of the law is indispensable to the growth and prosperity of the private pension system, so we urge you to consider simplification a subject within the scope of these hearings.

Thank you, Mr. Chairman.

Now, may I introduce Mr. Walker.

Mr. WALKER. Mr. Chairman, it is good to be before the subcommittee again to talk about the important role that CPA's play to ensure benefit security and to protect the integrity of our voluntary private pension system.

I am a member of the AICPA's employee benefit plan committee. As you know, I am a former assistant secretary of labor for ERISA. I am currently a partner with Arthur Andersen & Co.

Chairman PICKLE. May I also observe the valuable contribution you have given to this committee, particularly in our revision of the pension laws a year and a half ago. You were very helpful to our committee.

Mr. WALKER. Thank you, Mr. Chairman. Your leadership was instrumental, I think, in us being able to achieve those enactments.

When ERISA was enacted, as you know, Mr. Chairman, Congress incorporated a number of provisions that were designed to assure benefit security and protect the integrity of the voluntary private pension system. One of those provisions was to require that the financial statements of certain plans be subject to an annual audit by an independent public accountant and that such audit be conducted in accordance with generally accepted auditing standards. As a result of that requirement, most large plans, meaning plans with over 100 participants, are subject to an annual audit by an independent public accountant.

To put things in perspective, 10 percent of private pension plans are subject to an audit, and while that is only 10 percent of the plans, it represents 80 percent of all private pension assets. The objective of such a financial statement audit under generally accepted auditing standards is to express an opinion on whether the plan's financial statements, and in the case of ERISA certain supplemental schedules, fairly present the financial condition of the plan in accordance with generally accepted accounting principles, and that such statements are free from material misstatement.

However, there is currently a significant loophole in the audit requirement. That loophole is the current limited scope audit exception, which I will discuss a little bit later.

Annual audits of employee benefit plans play an important role in assuring that the information that is being provided to the Government and to plan participants on form 5500 fairly presents the financial condition of the plan in all material respects. This is important since form 5500 represents the foundation of the Government's enforcement program, at least the civil enforcement program.

In addition, annual audits, by an independent accountant, provides an important discipline on the plan's financial operations. It can also provide an important check and balance to prevent employee benefit plan abuse. However, an audit in accordance with generally accepted auditing standards is not designed to assure compliance with the many laws and regulations that apply to employee benefit plans.

Under ERISA, the plan's fiduciaries, including the plan administrator, the Department of Labor, the Internal Revenue Service, and in appropriate circumstances, the PBGC, have the primary responsibility to assure compliance with ERISA and applicable sections of the Internal Revenue Code.

We, as CPA's, are dedicated to doing our part to make sure that the benefit security of plan participants is protected and that the integrity of the system is maintained. Others must do theirs as well. In the final analysis, effective compliance in enforcement requires that a number of factors be addressed.

First, that there be improved stability and clarity with regard to the laws and regulations that apply to employee benefit plans. Because if individuals don't understand the laws or can't keep up with the frequent changes, it is difficult to comply. Second, that adequate information be disclosed and reported. Third, that the information that is provided be timely, useful and reliable. Fourth, that there be an adequate system to process that data and subject it to proper analysis. Fifth, that the Government have adequate resources to enforce the laws. Finally, that there be adequate penalties and remedies to deter abuse in addition to meaningful opportunities for participants and other affected parties to exercise their private rights of action.

With regard to what CPA's are doing to discharge our responsibilities, as you know, Mr. Chairman, in November 1989 the inspector general for the Department of Labor issued a report that was based upon a review of 279 employee benefit plan audits, which report was critical of the role that CPA's currently play relating to employee benefit plan audits. That report made a number of allegations with regard to audit deficiencies. It also included a number of related recommendations relating to employee benefit plan audits.

While the AICPA does not agree with all of the findings and recommendations contained in that report, we do, however, take very seriously any allegations of poor audit quality, and as a result of that IG report and concerns expressed by other members of the Department of Labor and Members of Congress, the AICPA has taken a number of definitive actions to try to address any areas of legitimate concern.

Those actions are detailed in my statement that has been provided for the record, Mr. Chairman. They include, among other things, the establishment of a standing committee on employee benefit plans to update the accounting and audit guide, and to deal with the Department of Labor and other Government officials on matters of concern relating to employee benefit plans, and numerous other actions.

We have been and will continue to work with the Department of Labor and the Congress to address any areas of concern regarding employee benefit audits, and I believe that our cooperation and progress over the last few months has been acknowledged by Secretary Dole, and then again today by Assistant Secretary Ball and Deputy Inspector General Maria.

With regard to the Department of Labor's audit related legislative recommendations that currently are before the Congress, the AICPA actually supports DOL's proposal to eliminate the current limited scope audit exception.

Chairman Pickle. Would you repeat that?

Mr. Walker. The AICPA strongly supports the Department of Labor's proposal to eliminate the current limited scope audit exception under section 103 of ERISA. In fact, the AICPA has been on record since 1978 in recommending that such provisions be eliminated.

~~We believe~~ the scope of the employee benefit plan audits should not be restricted. At the present time the hands of auditors have effectively been somewhat tied behind their backs since they can be precluded from subjecting certain assets held by banks, insurance companies, and other financial institutions to auditing procedures.

I might add that these amounts of assets are very, very significant as they relate to total plan assets. In fact, a majority of plan assets are eligible for the limited scope audit exception, and as a result, approximately one-half of all employee benefit plan audits that are being conducted at the present point in time result in a disclaimer of opinion.

Chairman Pickle. I believe that practically all groups have agreed on that limited scope aspect, and that is encouraging.

Mr. Walker. The AICPA also supports mandatory peer reviews of all public accounting firms that conduct employee benefit plan audits. In fact, all AICPA members, some 45,000 firms, must participate in a mandatory peer review of their accounting and audit practices every 3 years.

I might add that that 3 year period is the same period that is proposed by the Department of Labor. While we feel that while mandatory peer reviews should be required for firms engaging in employee benefit plan audits, we believe it is important that any such legislative proposal specifically acknowledge that the AICPA's current peer review practices would be acceptable for purposes of meeting these requirements.

The GAO has specifically endorsed the AICPA standards for certain audits and the SEC has supported the AICPA's peer review program. We feel it is very important to avoid any additional regulations of duplication or costs that would be associated with separate standards.

We are not saying that other ways might not be appropriate, but we are saying that, at a minimum, the AICPA program should be deemed to be a safe harbor, if you will, should such a provision is enacted.

With regard to compliance audits, which is the last section, Mr. Chairman, I was going to address, we note that the DOL has not made any related recommendations to date with regard to compliance auditing.

We feel it's important to note that compliance auditing is fundamentally different from a financial statement audit under generally accepted auditing standards that is designed to express an opinion on the plan's financial statements. Any compliance audit requirements, could be very costly and must be pursued with great care.

They must, among other things, be within the competence of CPA's. They must be specific as to what areas would be addressed as to what items would be tested, and they must provide for appropriate criteria that lend themselves to objective assessment.

If the Congress and the DOL feel that compliance testing is appropriate and cost-effective, we at the AICPA would be pleased to work with the DOL and the Congress to develop appropriate procedures that the auditor would apply and to develop appropriate reporting mechanisms in accordance with the AICPA standards.

That concludes my remarks, Mr. Chairman. I would be more than happy to answer questions.

[The statement and attachment of Mr. Hoffman and Mr. Walker follows:]

STATEMENT OF ARTHUR S. HOFFMAN AND DAVID M. WALKER, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. Chairman, I am Arthur S. Hoffman, Chairman of the Executive Committee of the Federal Tax Division of the American Institute of CPAs (AICPA). Joining me is David M. Walker, a member of the AICPA's Employee Benefit Plans Committee, a member of the Department of Labor's Advisory Council of Employee Welfare and Pension Benefit Plans, and also a former member of the PWBA. The AICPA represents approximately 300,000 members, many of whom provide professional services to pension plans.

The AICPA has been privileged to testify before this Subcommittee on vital issues in the past: Civil Tax Penalties, the "Tax Gap," and Funding of the Internal Revenue Service (IRS), to name a few.

We gather here today in a noble cause. Secretary of Labor Elizabeth Dole captured its essence in a recent speech. Referring to pension security she said:

> We will strive to ensure that every participant receives the benefits to which he or she is entitled.

Her pledge, I am sure, would be seconded by every one of us, and, most certainly, by the members of the AICPA. Her goal is important to the vigor of both our economic and democratic systems.

It is most frequently the CPA who prepares the reports which are integral to the enforcement process. These documents are critical to detection, by the IRS and the Department of Labor (DOL), of actions which may prejudice the employee's interests. We do appreciate the importance of our role. To illustrate the point, I quote again from Secretary Dole's speech. She said:

> We have been working closely with the American Institute of Certified Public Accountants on all audit related issues, including compliance testing... I am pleased to report that our negotiations with the AICPA on this matter are progressing constructively.

There are two critical areas of inquiry in determining whether Congress, and the regulatory agencies have done everything possible to accomplish our common goals:

- The adequacy of the rules, including the penalty provisions; and
- The clarity of disclosure provided by the reports.

ENFORCEMENT RULES

If you examine the rules objectively, you must conclude that they are potentially a potent array of weapons to safeguard the retirement benefits of the American worker. The simple fact is that the fiduciary who violates the rules imperils both his personal wealth, and, indeed, his freedom.

ERISA requires a fiduciary to perform his duties solely in the interests of the participants and their beneficiaries; and he must use the care and skill of a prudent man. He must diversify investments to minimize risk; and he must follow the terms of the plan.

The fiduciary is personally liable for losses for breach of duty; and for restoration of profits if he has used the plan assets to personal advantage.

The ERISA rules and the DOL and Treasury regulations, and case law fill in a mass of details.

Actions for relief from misuse of plan assets or failures to disclose may be brought by the government agency, participants, beneficiaries and fiduciaries.

The penalties for transgressions are high and comprehensive. Prohibited transactions are a target, as they should be. Prohibited transactions generally involving dealings between the plan and "disqualified persons." That term encompasses all who have authority or control of the plan, and by their position are not deemed able to deal with the plan at arm's length.

There are civil and in some instances criminal penalties for:

- Failure to provide information to the DOL, IRS and participants;
- Late filings;
- Engaging in prohibited transactions;
- Providing false statements or concealing facts;
- Failing to meet minimum funding requirements;
- Preparing deficient tax returns;
- Claiming excessive deductions by overstating the employer's pension liability;
- Reverting of excess assets to the employer.

In addition, a plan can be denied qualification or disqualified by the IRS for not operating exclusively for benefit of the employees.

We referred to these rules as "potentially a potent array of weapons." We say "potential" because they are hollow promises to American workers in the absence of aggressive enforcement. We will cover this point in a moment when we offer our recommendations.

REPORTS

The DOL and the Pension Benefit Guaranty Corporation (PBGC) receive annual reports and the IRS receives annual returns from Plan Administrators. (IRS Form 5500, Annual Return/Report of Employee Benefit Plan.) The Annual Report is audited by an independent public accountant if the plan has more than 100 participants. Participants also are entitled to information concerning the plan and their accrued benefits.

An enormous amount of information is currently provided in the annual returns and reports. If somehow they are deficient, if they are not flagging the issues that deserve scrutiny, they must be re-designed or supplemented. I will cover this too in our recommendations.

RECOMMENDATIONS

Penalties

I briefly described the array of penalties available to the IRS, DOL and PBGC to deter and to punish those who abuse their fiduciary position. It is tempting to add another layer of penalties or make them more severe. That was the pattern prevailing before 1989, when you, Mr. Chairman, initiated penalty reform. The penalty rules had become unadministerable because each newly perceived abuse over the years was met with a newly devised penalty. We recommend that the pattern not be revived. The penalties now are intimidating enough; it is enforcement which must be intensified.

Reports

Earlier we stated that the currently required reports contain an enormous amount of information.

However, they may not be adequately detailed and revealing. The IRS and DOL must be put on clear notice of acts which might deplete plan assets, so that they can act quickly to stop the hemorrhaging.

We recommend that the returns and reports be carefully analyzed for the adequacy of their disclosure by experts in the fields of pension plan administration, fiduciary legal responsibilities, accounting, etc. These experts should be gathered from the IRS, DOL and professional firms. Proposals to modify or supplement the returns and reports should be implemented promptly.

The role of CPAs in the information process can be enhanced. A recent report of the Office of the Inspector General of the DOL makes recommendations concerning the role of CPAs including:

- Elimination of restrictions on the scope of our audits; and
- Revision of the AICPA's audit guide for employee benefit plans.

We welcome these recommendations, and my colleague and co-witness David Walker will discuss these points.

Setting Standards

We call your attention to a section of the excellent report of the Staff of the Joint Committee on the subject of your hearing, captioned "Purchase of Annuities by Pension Plans." The section states:

> There has also been recent concern regarding the solvency of insurance companies from which commercial annuities are purchased by retirement plans.
>
> ...
>
> While the choice of an insurance company is a fiduciary decision under ERISA..., ERISA does not contain specific guidelines regarding the purchase of such annuities. The PWBA (Pension and Welfare Benefits Administration) and the PBGC have indicated that they intend to take appropriate action to address this issue. (Report, p. 24)

Mr. Chairman, CPAs can cooperate with the IRS and DOL in devising the most complete and detailed returns and reports, and prepare them with total dedication to complete disclosure. But, the agencies must decide what is prejudicial to the interests of the American worker, in order to perform a purposeful review of those returns and reports.

In the starkest terms non-diversification is risky. The solvency of any single investment vehicle is never absolutely certain.

Furthermore, the selection of an investment paying the highest available rate of return should raise the question: is the primary purpose to lower the employer's current contribution, as opposed to assuring that the employees' retirement benefits will be paid?

In this case, and in many others, the ERISA rules and case law interpretations could readily serve as the basis for guidelines for the enforcement agencies to prevent abuses. The AICPA recommends that the drafting of such guidelines be given the highest priority.

Training

Whatever information is provided to an enforcement agency, and whatever enforcement rules are available, the critical added ingredient is the capability and willingness of the individual scanning the information to analyze it critically, and act responsively. Perfunctory reviews should not be tolerated, for defects in the operation of a plan ordinarily will not appear on the surface.

The IRS generally reviews the tax returns of for-profit companies for completeness and mathematical accuracy. But, it does not generally concern itself with the capability and honesty of management. That is the subtle area of fiduciary responsibilities: normally the exclusive province of probate courts, the sophisticated trust and estate bar, and specialists with banks and CPA firms. Yet it is precisely this area which has been assigned to the IRS and DOL in the case of pension plans.

We recommend that IRS and DOL reevaluate their training programs, and the checklists and processing of the annual reports and returns so that issues are detected, and pursued.

IRS and DOL Resources and Funding

We have stated that the rules, in theory, do protect the interests of the American worker. Vigorous enforcement of those rules is the key to turning that theory into reality.

We recommend that Congress be receptive to requests from the IRS and DOL to enhance their capability to insightfully review returns and reports, and to quickly send out well trained examiners in appropriate circumstances.

Roundtable Discussion

Mr. Chairman, you personally have elevated the legislative and regulatory process in the past by calling for roundtable discussions to develop a consensus and broad support for the proposal. That method would be ideal to address the subject of today's hearing.

The goal - to ensure that every participant receives the benefits to which he or she is entitled - is shared by all parties. And, since there is no lack of rules, the process of refining them can best be accomplished with input from experts in various professional disciplines.

Simplification

Mr. Chairman, I have one final point to make before I yield to my colleague. The AICPA fears that the complexity of the rules governing pension plans is discouraging companies from adopting plans or maintaining them. We are seeing too many terminations and freezes, and lack of enthusiasm to commence plans, especially among small and medium-sized businesses.

It is one thing for us to meet today to see how we can preserve the benefits already promised to the American worker. But many will suffer hardship in retirement if companies lose interest in providing benefits out of fear of governmental regulatory quagmires.

Chairman Rostenkowski wisely requested interested parties to submit proposals to simplify any and all aspects of the tax law. The AICPA did so, and a key section of our recommendations was on pension and profit sharing plans.

We have taken the liberty of appending that section to our written testimony. We believe that simplification of the law is indispensable to the growth and prosperity of the private pension system. So, we urge you to consider simplification a subject within the scope of these hearings.

Thank you, Mr. Chairman and now I introduce Mr. David Walker.

INDEPENDENT AUDITS OF BENEFIT PLANS

Overview of ERISA and Related Regulations

The primary purpose of ERISA is to protect the interests of workers, retirees, and their beneficiaries. ERISA seeks to attain that objective by requiring disclosures to participants and beneficiaries, by establishing standards of conduct for plan fiduciaries, by requiring financial reporting to government agencies, and by providing appropriate remedies, sanctions, and access to the federal courts.

ERISA generally applies to employee benefit plans that are established or maintained by plan sponsors engaged in interstate commerce or in any industry or activity affecting interstate commerce.

Reporting and Disclosure

ERISA requires that various reports be prepared and filed with the IRS and that others be furnished to plan participants and beneficiaries, the DOL, and the PBGC. The plan administrator is required to comply with certain reporting and disclosure requirements by filing certain information with the DOL and providing certain information to plan participants and beneficiaries. Most plans must file an annual report that includes plan financial statements and schedules, an actuarial statement (for defined benefit pension plans) certified by an enrolled actuary, and certain other information with the IRS, which processes these forms for itself, the DOL, and the PBGC.

Annual Report

The report of most significance to the independent auditor and the federal government is the annual report (Form 5500 series). Generally, plans with 100 or more participants at the beginning of the plan year must file an annual report (Form 5500) containing, with certain exceptions, financial statements, supporting schedules, footnotes required for a full and fair presentation, and an independent auditor's report. The auditor's report is based upon an audit of the plan's financial statements conducted in accordance with generally accepted auditing standards.

Auditor's Responsibility Under Generally Accepted Auditing Standards

The auditor's objective and responsibility, under generally accepted auditing standards (GAAS), is to express an opinion on whether the financial statements of an entity are fairly presented in accordance with generally accepted accounting principles and are free from material misstatements, whether caused by fraud or error. In so doing, the auditor gives reasonable assurance to the users of those statements that the financial information including total assets and liabilities reported by the entity is credible.

Auditing standards and procedures, audit quality controls, and individual auditor performance are essential elements in achieving that objective. To help auditors achieve the objective of an audit conducted in accordance with GAAS, the AICPA has established a number of interrelated programs to strengthen standards of auditor performance. In this respect--

- the AICPA has adopted and continuously augments auditing standards and other types of auditor guidance;
- the AICPA has adopted quality control standards that are required to be followed by all members who perform audits;
- for more than ten years, the AICPA's Division for CPA Firms has monitored compliance by its members with quality control and auditing standards through a comprehensive program of peer reviews;
- more recently, the AICPA has adopted a program of mandatory reviews for all members in public practice who provide audit and accounting services; this new Quality Review Program has begun this summer; and
- the AICPA administers programs as part of an overall system--which includes state boards of accountancy, state CPA societies, and the courts--to deal with allegations of individual misconduct.

Over the years, the system of public and private sector supervision of the financial reporting process in the United States has evolved to produce the world's most comprehensive and reliable financial information. That system also has demonstrated remarkable adaptability to respond to changing circumstances. An audit of financial statements conducted in accordance with generally accepted auditing standards is not the only means of assuring compliance with the provisions of ERISA. Under the law, plan administrators, the IRS, and the DOL have the responsibility to assure compliance with ERISA's provisions. The annual report and the financial statements prepared by the plan administrator and the independent auditor's report contributes to the monitoring activities of these parties and agencies. An audit is an important discipline on the financial information reported by the plan administrator of the covered plans, but it is not designed to assure compliance with all legislative and regulatory requirements that relate to employee benefit plans.

The AICPA's Actions Relative to Audits of Employee Benefit Plans

In November 1989, the DOL's Inspector General issued a report which was based on a review of certain audits of ERISA plans and reported certain alleged deficiencies. Some of those deficiencies related to ERISA's disclosure requirements while others dealt with the quality of audit work performed. Because the AICPA takes most seriously any allegation of poor audit quality, it has taken a number of steps to address the findings and recommendations included in the IG's report.

Where deficiencies exist, we believe the primary causes are twofold:

- lack of understanding by some auditors of the unique requirements of ERISA-required audits, and
- failure by some auditors to follow the guidance contained in the AICPA's accounting and audit guide relating to employee benefit plans

The AICPA has taken a number of steps that were specifically designed to improve the quality of employee benefit plan audits. They include--

- establishing an Employee Benefit Plans Committee to revise the accounting and audit guide and to work with the DOL on other related matters.
- assigning maximum priority for the timely issuance of the revised employee benefit plan accounting and audit guide, including addressing areas requiring special attention such as specifying procedures relative to party-in-interest transactions and clarifying the auditor's responsibility FOR information included in Form 5500.
- preparing checklists for use by practitioners in connection with auditing for defined benefit plans.
- publicizing the results of the IG's study and findings in publications that are sent to AICPA members.
- meeting with DOL officials to discuss the IG's report and related recommendations.
- sending the IG's report to all firms included in the IG's study to inform them of the IG's findings, suggesting that they review their practices in this area, and requesting their comments and suggestions, if any.
- sponsoring, with the participation of the DOL, the first national training conference on auditing employee benefit plans to be held in Washington on December 10-11, 1990.
- informing practitioners of important developments in ERISA and AICPA requirements through a new industry update.
- recommending to the DOL a cost-effective approach for ERISA compliance audits if

Congress and the DOL decide to require auditors to test and report on certain ERISA compliance matters.

Updating Guidance Relative to Audits of Employee Benefit Plans

We are working directly with the DOL in revising the AICPA accounting and audit guide to incorporate the recently issued auditing standards as they relate to employee benefit plan audits and other developments. For example, as stated above, we will expand the guide to include procedures for identifying parties in interest, as defined by ERISA, and transactions with those parties. The revised guide will also require the independent auditor to review the Form 5500 filed by the plan administrator for consistency with the plan's audited financial statements.

The industry update, "Employee Benefit Plans Industry Developments - 1990," prepared in consultation with the DOL, alerts the reader to:

- the increasing challenge for fund managers to manage asset quality and the significant changes over time in the types of retirement plans offered by companies,
- the DOL's comprehensive edit checks of Form 5500 and related civil penalties imposed on the plan administrators for failure to file a proper Form 5500 report, and
- frequent disclosure omissions to plan financial statements and supplemental schedules required by ERISA.

Full-Scope Audits

The AICPA fully supports the DOL's proposal to require full-scope audits by eliminating the current limited scope provision included in ERISA. We are on record, beginning in 1978, as stating that the scope of the audit should not be restricted in any way. Plan participants can not be provided the full assurance contemplated by ERISA if the audit is restricted, as currently permitted by ERISA Section 103(a)(3)(C).

Peer Review Proposal

Maintaining and improving the quality of independent audits is one of the highest priorities of the AICPA. In 1977, we took a major step to achieve that objective. In that year, the Institute established its Division for CPA Firms, consisting of an SEC practice section and a private companies practice section. Both sections have a number of membership requirements, and both sections share the same cornerstone: a requirement that every member firm undergo every three years an independent review of its compliance with professional standards in the conduct of its accounting and auditing practice.

Those voluntary programs were successful. As a result, in January 1988 the Institute's membership made participation in that kind of practice-monitoring program a condition for continued AICPA membership. Now, all AICPA members in public practice--who perform the vast majority of audits in this country--must have their accounting and auditing practices reviewed every three years.

Mr. Chairman, you should know that these are not unsubstantiated claims. The Securities and Exchange Commission (SEC) has reported to the Congress for some years that the review program of the SEC practice section has been effective in improving the quality of practice before the Commission. And the U.S. General Accounting Office (GAO), which has recognized the value of quality review for all audit organizations, has stated simply, after its own study of our programs, that "Public accountants should participate in the AICPA practice-monitoring program or an equivalent program."

We make these observations for your consideration because, although we support mandatory reviews of all public accounting firms that audit employee benefit plans, we would not be able to support regulation that would supplant the standards, procedures, and guidelines that we have developed as a result of extensive and expensive experience. Our programs are working. They cover 45,000 firms. We believe the Department can rely on those programs and on the standards and procedures that govern them. Additional, specific regulation would only make it more difficult to carry out an effective, self-regulatory practice-monitoring program, especially when you consider that other agencies of government might over time impose their own, different requirements.

We hope the Committee will encourage the Department to accept the Institute's programs--as the GAO has--and discourage the issuance of new, costly and unnecessary regulations. We would, of course, be happy to provide the Subcommittee with additional information about our review programs for your consideration.

ERISA Compliance Testing

If the DOL and Congress wish the independent auditor to do work in addition to an audit of the financial statements of a covered plan that would include a report on compliance with certain laws and regulations, the AICPA will gladly work with the DOL to accomplish it. The DOL and Congress must be explicit in what is to be required. The laws and regulations and the criteria against which the auditor would be required to test and report must be clearly defined and specified. For example, they must relate to financial matters within the competence of auditors, and the DOL and Congress must establish requirements with sufficient precision to permit objective evaluation of plan compliance. There must be reasonable criteria to measure compliance. This approach affords the DOL the opportunity to specify the procedures it wishes auditors to perform, including testing for violations of ERISA in specific areas which are beyond the scope of an audit of the financial statements.

The additional work required for the plans may entail significant costs. However, if the Congress and the DOL believe that this additional work is desirable and beneficial, we would be pleased to work with the DOL to develop the necessary procedures that the auditor would apply in testing such compliance and issuing the appropriate report in accordance with applicable attestation standards issued by the AICPA.

* * * * *

Mr. Chairman, that concludes our prepared remarks. We will now attempt to answer any questions you or members of the Subcommittee may have.

AICPA Tax Simplification Recommendation

USE ONE SET OF TERMS TO APPLY THE QUALIFICATION, DEDUCTION AND DISTRIBUTION RULES AND CONFORM THE TERMINOLOGY OF THE CODE WITH THE TERMINOLOGY OF TITLE I OF ERISA

Present Law

The Code currently uses two sets of terms to describe qualified retirement plans: pre-ERISA terms and ERISA terms. The pre-ERISA terms are profit-sharing plans, pension plans, and stock bonus plans. The ERISA terms are defined contribution plans and defined benefit plans. Every plan has a pre-ERISA and an ERISA name and a taxpayer must know both names for each plan in order to accurately apply the rules in the Code to a particular plan. For example, most of the ERISA qualifications sections, e.g. section 415, refer to defined contribution and defined benefit plans. Many of the pre-ERISA Code sections, e.g. sections 402 and 404, refer to pension plans, stock bonus plans, and profit-sharing plans.

In general, there are three types of defined contribution plans: profit-sharing plans, stock bonus plans, and money purchase pension plans. TRA 86, however, eliminated the requirement that contributions to a profit-sharing plan must be made from an employer's current or accumulated profits. This eliminates a major difference between profit-sharing plans and other defined contribution plans. The remaining distinctions include the requirement that a money purchase pension plan have fixed annual contributions while a profit-sharing plan may have fixed or discretionary annual contributions. A second distrinction exists with respect to when distributions may be made from each of these plans. A third distinction is that the limitation for deductible contributions is generally 15% of compensation for a profit-sharing or stock bonus plan and 25% of compensation for a money purchase pension plan.

Finally, the primary distinguishing characteristic of a stock bonus plan is that the participants of a stock bonus plan have a right to demand their distribution in employer securities while participants in profit-sharing and money purchase pension plans are not required to have that right.

Suggested Change

The Code should be structured around the ERISA terms - defined contribution and defined benefit plans. The elimination of the "profits" requirement for a profit-sharing plan leaves very little distinction between the types of defined contribution plans from a definitional point of view. It is difficult to see what policy purpose is now served by using two terms in the Code to describe each plan. While distinctions would continue to be permitted between the types of defined contribution plans, for example an employer could still establish a plan calling for either fixed or discretionary contributions or one that mandates distributions in employer stock, those distinctions would be meaningless in applying the qualification, deduction and distribution rules.

Contribution to Simplicity

This proposal would allow taxpayers to use one set of terms to apply the qualifications, deduction and distribution rules. This proposal would also conform the terminology of the Code to the terminology of Title I of ERISA (the rules administered by the Department of Labor) facilitating the ability of taxpayers to understand both the non-tax and tax consequences of their actions. Specifically, sections 401(a)(27) and 401(a)(23) would be repealed.

AICPA Tax Simplification Recommendation

SEGREGATE LEVERAGED ESOPs FROM THE QUALIFIED PLAN REQUIREMENTS AND TREAT THEM AS A SEPARATE FINANCING VEHICLE

Present Law

Various leveraged ESOP requirements can be found throughout the qualification and other sections of the Code that deal with qualified retirement plans. For example, sections 401(a), 404, 409, 415 and 4975 all deal with leveraged ESOPs as well as such other qualified plans.

Suggested Change

The leveraged ESOP requirements should be removed from the qualified plan rules and collected in a separate subchapter of the Code. The rationale is that, in substance, leveraged ESOPs have tended to be a financing vehicle rather than a retirement vehicle, although they have attributes of both. There are a number of requirements that are unique to leveraged ESOPs which appear throughout the qualified plan rules. Unless someone is intimately familiar with all these rules and their location in the Code, the chance of their overlooking a particular requirement is unnecessarily high. Isolating these rules from the qualified plan rules would eliminate a source of complexity in the qualified plan rules, recognize the unique nature of leveraged ESOPs and collect the related rules in one subchapter.

It is not being proposed that the leveraged ESOP rules be repealed. What is being proposed is that these requirements be collected separately in their own subchapter so that someone need not be an ESOP expert in order to answer a question with respect to them.

Contribution to Simplicity

When dealing with qualified retirement plans, the following sections would no longer need to be considered: sections 401(a)(28), 409, 404(a)(9), 404(k), 415(c)(6), 4975(e)(7) and 4975(d)(3). These sections would be collected in a separate subchapter of the Code.

AICPA Tax Simplification Recommendation

PROVIDE A UNIFORM DEFINITION OF COMPENSATION FOR PURPOSES OF THE EMPLOYEE BENEFIT RULES

Present Law

Code sections 414(s), 414(q), 415 and 401(a)(17) all provide different definitions of "compensation." Because of the significance of this concept throughout the employee benefits sections of the Code, it is important to have a simple, uniform definition.

Suggested Change

A uniform definition of compensation should be established to simplify the task of plan sponsors and administrators.

The uniform definition should be tied to taxable compensation with elective contributions under sections 125, 401(k), 408(k), 403(b), 457 and 501(c)(18) added back at the employer's election on a uniform and nondiscriminatory basis. For example, a calendar year plan would simply use W-2 compensation including the specified elective contributions if the employer elects. A fiscal year plan could either determine taxable compensation on the fiscal year basis or use W-2 compensation for the calendar year which ends in the fiscal year. This definition should be used for all purposes of the employee benefit rules.

Contribution to Simplicity

A uniform, simplified standard for compensation would reduce complexity in plan design and administration and eliminate the existing trap for the unwary.

AICPA Tax Simplification Recommendation

ELIMINATE, TO THE EXTENT POSSIBLE, THE REMAINING STATUTORY DISTINCTIONS BETWEEN SELF-EMPLOYED INDIVIDUALS AND COMMON LAW EMPLOYEES

Present Law

Beginning with the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), distinctions between the qualified plan rules applicable to self-employeed individuals and those applicable to common-law employees have slowly been eliminated. This has significantly simplified the law. However, several distinctions remain between the rules applicable to plans covering owner-employees (certain self-employeed individuals) and other participants.

Under current law, owner-employees are subject to unique aggregation rules (section 401(d)) and cannot obtain loans from qualified plans under the same terms as other participants.

Other areas which involve a distinction between "owner-employees" or "self-employed individuals" and other participants are sections 401(c)(1), 401(c)(2)(A), 402(e)(4)(A)(ii), 403(a)(3), 404(a)(8), 404(e), 408(k)(7)(A), 415(b)(3), 415(c)(3)(B), 416(i)(3) and 72(m)(6). Still other sections limit contributions to earned income (section 404(a)(8)(C)), preclude the use of contributions made to a qualified plan on behalf of a self-employed individual to purchase life, accident, health or other insurance (sections 408(a)(8)(C) and (e)), prohibit deductible contributions exceeding earned income (section 404(a)(8)(C)), permit disability of a self-employed person to qualify as a triggering event for lump-sum distribution treatment (sections 402(e)(4)(A)(iv) and 72(m)(6)), discuss the rules of annuity taxation (section 403(a)(3)) and define compensation for purposes of the annual additions limitations (sections 415(b)(3) and 415(c)(3)(B)) or the deduction limitations (section 401(c)(2)(A)(v)).

Suggested Change

Those distinctions that remain after TEFRA can be divided into two groups: 1) those designed to treat certain self-employed individuals differently from other plan participants (the owner-employee rules) and 2) those necessary to make sure there is equivalent treatment between self-employed individuals and other participants. Eliminating the first set of distinctions would simplify the law without sacrificing any significant policy goals. It is proposed that the flush language in section 4975(d) that prohibits loans from qualified plans to participants who are owner-employees be repealed. The special aggregation rules of section 401(d) should also be repealed. These changes would eliminate an existing trap for the unwary as well as simplify the Code.

Retention of the second set of distinctions will ensure equivalent treatment between self-employed individuals and other participants.

Contribution to Simplicity

The flush language in section 4975(d) would be repealed. Also repealed would be sections 401(c)(3), 401(c)(5), 401(d) and 401(a)(10)(A). Section 416(i)(3) would be repealed as part of an overall repeal of the top-heavy rules discussed later.

AICPA Tax Simplification Recommendation

SIMPLIFY THE DEFINITION OF A HIGHLY COMPENSATED EMPLOYEE UNDER SECTION 414(q)

Present Law

Under current law, a highly compensated employee is defined as any employee who during the current or preceding year was:

a. a 5% owner;
b. received compensation from the employer in excess of $75,000;
c. received compensation from the employer in excess of $50,000 and was in the top-paid group of employees for such year; or
d. was an officer and received compensation greater than 50% of the amount in effect under section 415(b)(1)(A) for such year.

A participant who is described in b, c or d above (for the current plan year only), shall not be a highly compensated employee unless he is among the 100 employees paid the greatest compensation during the year.

Suggested Change

One of the key concepts that permeates the entire qualified plan area is the prevention of discrimination in favor of "highly compensated" employees. Under TRA 86, the Code for the first time specifically set forth rules for determining who is in this group. However, the definintion is difficult to work with and a clear simple definition would reduce complexity. It is recommended that the Code define the highly compensated group as: 1) 5% owners with attribution (as defined in section 318 of the Code) and 2) those earning compensations in excess of $75,000 (indexed for inflation).

In addition, the "highly compensated" group would be determined on the basis of the preceding plan or employer year, not the current and preceding years as under current law.

Contribution to Simplicity

The proposal would simplify plan administration and testing because the highly compensated group would be easy to identify.

AICPA Tax Simplification Recommendation

REPEAL THE TOP-HEAVY RULES

Present Law

The top-heavy provisions, enacted as part of TEFRA, provide for accelerated vesting, minimum benefit accrual and a limit of $200,000 on the amount of compensation that can be taken into account under a qualified plan. Congress concluded that in the case of plans under which more than 60 percent of the benefits are focused on key employees, special rules were needed to assure that the rank-and-file employees would receive the benefits that the tax incentives were provided to encourage.

TRA 86 significantly lessened the differences between top-heavy and non-top-heavy plans by capping the amount of compensation taken into account at $200,000 for all qualified plans and also accelerating vesting schedules for all qualified plans. The allowable vesting schedules are:

	Cliff Vesting		Graduated Vesting	
Yrs. of Service	Top-Heavy	Other	Top-Heavy	Other
1	0	0	0	0
2	0	0	20	0
3	100	0	40	20
4		0	60	40
5		100	80	60
6			100	80
7				100

A plan that is top-heavy must also provide a minimum defined benefit for non-key employees equal to 2% multiplied by the number of years of service with the employer (up to a maximum of 20%) times the individuals' "compensation." A non-key participant's compensation is determined over the period of consecutive years, not in excess of 5, that the participant's compensation was the highest. In a defined contribution plan, a minimum defined contribution amount of 3% of compensation, or the amount of the actual percentage contribution made on behalf of key employees, if less, must be made on behalf of non-key employees. Social Security contributions or other legally required contributions cannot be taken into account for purposes of these benefit requirements.

Non-top-heavy plans are not required to provide minimum benefit levels; however, contributions may not be skewed in favor of the highly compensated (section 401(a)(4)) and the Social Security integration rules now require minimum benefit levels for integrated plans.

Suggested Change

The special rules of section 416 should be repealed. While section 416 served a purpose when it was passed, one limitation imposed by section 416 ($200,000 cap on compensation) now applies to all plans and another (faster vesting) is virtually the same for top-heavy and non-top-heavy plans. The other significant difference between top-heavy and non-top-heavy plans involves benefit accrual, and with recent changes in the permitted disparity rules in TRA 86, this difference is significantly less than it was in 1982. the regulations to be issued under section 401(a)(4) could provide further guidance if any perceived gaps exist.

The top-heavy rules also contain their own definition of the employees in whose favor discrimination is prohibited ("key employee"). Following TRA 86, most Code sections affecting discrimination use the term "highly compensated employee." At a minimum, the use of the term "key employee" should be eliminated and the TRA 86 definition of highly compensated employee substituted.

In view of the fact that virtually all plans must include these provisions, and that the incremental benefit of the top-heavy rules has been diminished by subsequent changes in the Code, these provisions could be eliminated with little adverse impact on participants and reduce complexity in the law and plan documents.

Contribution to Simplicity

Repeal of sections 416 and 401(a)(10)(B) and the yearly testing that is required under the provision is recommended.

AICPA Tax Simplification Recommendation

RECONSIDER SECTION 401(a)(26)

Present Law

Section 401(a)(26) provides that each plan, independently, must cover the lesser of 50 employees or 40% of the total employees of an employer (determined on a controlled and aggregated group basis).

Suggested Change

The section 401(a)(26) minimum participation rules are aimed at preventing multiple plans covering few employees from discriminating aginst nonhighly compensated employees. Section 410(b) is also aimed at preventing discrimination against nonhighly compensated employees, but may be applied on a group plan basis if such plans are comparable in accordance with Rev. Rul. 81-202, 1981-2 CB 93.

In enacting section 401(a)(26), the legislative history indicates Congressional concern that although plans that are aggregated are required to satisfy comparability requirements with respect to the amount of contributions or benefits, such an arrangement may still discriminate in favor of the prohibited group. Differences in the rates at which benefits are accrued (e.g. presence or absence of past service credit) and the selective use of actuarial assumptions in valuing plan benefits may cause a plan that satisfies the requirement of comparability with respect to the amount of contributions or benefits to favor the highly paid. Similarly, in the case of plans that are comparable with respect to the amount of contributions or benefits, discrimination favoring the highly paid may occur because of disparate funding levels and benefit options that are not taken into account in such a comparability analysis.

Congress was concerned that because of the large number of these arrangements, the inherent complexity of comparability analysis, and the difficulties in discovering all differences in funding levels and benefit options, the IRS lacked sufficient resources to monitor compliance with the nondiscrimination standards by small aggregated plans. Thus, Congressional intent may be summarized as desiring to obtain both nondiscrimination and simplicity. The regulations issued under section 401(a)(26) by all standards are anything but simple.

The Service has stated that it will soon issue a new revenue ruling which will expand upon Rev. Rul. 81-202 and make it more difficult to discriminate using comparability of plans in order to satisfy section 410(b).

Eliminating one-person plans or highly specialized plans that cover small numbers of employees is appealing in reducing the number of plans maintained by a controlled group and in easing the audit burden of the Internal Revenue Service. However, unless the regulations under section 401(a)(26) can be re-drafted in a manner that reflects the straightforward manner of the statute, then section 401(a)(26) should be repealed. If the regulations can be properly drafted, the repeal of section 401(a)(26) may not be necessary.

If the regulations cannot be re-drafted and if section 401(a)(26) is repealed, then any perceived problems with comparable plans should be dealt with directly by amending the rules of Rev. Rul. 81-202. Section 410 should adequately cover the objective of preventing plans from being discriminatory against the nonhighly compensated. If any gaps exist, the forthcoming revenue ruling, final section 410(b) regulations, or additional pronouncements from the Service, could cover them. Alternatively, the percentage tests of section 401(b) could be increased above 70% to minimize any abuses. This proposal is one which could result in some incremental discrimination above that allowed by current law, but the reduction in complexity achieved would be substantial.

Contribution to Simplicity

The complexity resulting from section 401(a)(26) and the regulations promulgated thereunder would be eliminated.

AICPA Tax Simplification Recommendation

ELIMINATE THE ABILITY TO PROVIDE MEDICAL BENEFITS TO RETIREES FROM QUALIFIED PLANS

Present Law

IRC section 401(h) allows certain medical benefits to be paid to retirees from qualified retirement plans. Under the statute, a pension or annuity plan may provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses and dependents, but only if the following six requirements are met:

a. the benefits are subordinate to the retirement benefits provided by the plan;
b. a separate account is established and maintained for these benefits;
c. the employer's contributions to the separate account are reasonable and ascertainable;
d. the corpus or income of the separate account cannot be diverted to any purpose other than providing these benefits;
e. if all liabilities to provide these benefits under the plan are satisfied, any amount remaining must, under the terms of the plan, be returened to the employer; and
f. for each key employee, a separate account is established and maintained for these benefits.

"Subordinate" has been defined in the regulations to mean that at all times the aggregate contributions to provide such medical benefits (and any life insurance protection) does not exceed 25% of the aggregate contributions, other than contributions to fund past service liability.

Suggested Change

Provided other adequate means are available for pre-funding retiree medical expense, qualified retirement plans should not be allowed to provide medical benefits for retirees. Qualified retirement plans are plans of deferred compensation designed to replace wages upon retirement, not plans designed to replace an employee's entire compensation arrangement. These accounts cause additional complication in plan documents, plan administration, and plan design.

It is not being proposed that employers not be allowed to pre-fund any other of their retiree medical liability. Those who wish to pre-fund this obligation could do so on a tax-preferred basis by utilizing a voluntary employee beneficiary association (VEBA) described in section 501(c)(9). In order for this to be an adequate alternative, however, the VEBA rules need to be amended so that employers can more adequately fund their retireee health obligations, e.g., earnings on funds set aside for retiree health obligations should not be subject to unrelated business income tax.

Contribution to Simplicity

The elimination of sections 401(h) and 415(l) and modification of section 404(e).

AICPA Tax Simplification Recommendation

THE ELIMINATION OF SECTIONS 401(h) AND 415(l) AND MODIFICATION OF SECTION 404(e)

Present Law

Section 1.401-4(c)(2)(ii) requires that the employer contributions which are used for the benefit of any employee who is among the 25 highest paid employees of the employer be restricted if the plan is terminated within 10 years after its establishment of the plan.

Section 415 limits the amounts which may be paid from a defined benefit plan. After TRA 86, the maximum benefit payable under section 415 cannot accrue any faster than ratably over 10 years of plan participation.

Suggested Change

Under section 415, the benefits which may be paid to an employee are limited to no more than $90,000 (indexed) or 100% of compensation actuarially reduced for early retirement. In addition, section 415 now sets forth the requirement that the maximum benefit payable may only be accrued ratably over 10 years of plan participation. This prevents a highly compensated employee from receiving a large benefit shortly after a plan has been established. This structure significantly diminishes the possibility of abuse at which section 1.401-4(c) is aimed. In addition, this regulation was adeopted before ERISA, which introduced the Pension Benefit Guaranty Corporation and minimum funding rules. Both innovations have also helped to prevent the type of abuse which this regulation was originally enacted to prevent. Finally, the new minimum funding rules under the Omnibus Reconciliation Act of 1987 (OBRA) also help to ensure that plan participants and beneficiaries are protected from the type of abuse at which this regulation is aimed.

Due to the diminished possibility of abuse, section 1.401-4(c) of the regulations should be revoked. This is a situation where significant reduction in complexity could be achieved by eliminating a largely redundant provision.

Contribution to Simplicity

Treasury regulation section 1.401-4(c) should be eliminated and, therefore, plan design would be simplified.

AICPA Tax Simplification Recommendation

ELIMINATE SECTION 1.401-4(C)(2)(ii) CONCERNING RESTRICTION OF BENEFITS WHICH MAY BE PAID TO THE 25 HIGHEST PAID EMPLOYEES

Present Law

Section 1.401-4(c)(2)(ii) requires that the employer contributions which are used for the benefit of any employee who is among the 25 highest paid employees of the employer be restricted fi the plan is terminated within 10 years after its establishment of the plan.

Section 415 limits the amounts which may be paid from a defined benefit plan. After TRA 86, the maximum benefit payable under section 415 cannot accrue any faster than ratably over 10 years of plan participation.

Suggested Change

Under section 415, the benefits which may be paid to an employee are limited to no more than $90,000 (indexed) or 100 percent of compensation actuarial reduced for early retirement. In addition, section 415 now sets forth the requirement that the maximum benefit payable may only be accrued ratably over 10 years of plan participation. This prevents a highly compensated employee from receiving a large benefit shortly after a plan has been established. This structure significantly diminishes the possibility of abuse at which section 1.401-4(c) is aimed. In addition, this regulation was adopted before ERISA, which introduced the Pension Benefit Guaranty Corporation and minimum funding rules. Both innovations have also helped to prevent the type of abuse which this regulation was originally enacted to prevent. Finally, the new minimum funding rules under the Omnibus Reconciliation Act of 1987 (OBRA) also help to ensure that plan participants and beneficiaries are protected from the type of abuse at which this regulation is aimed.

Due to the diminished possibility of abuse, section 1.401-4(c) of the regulations should be revoked. This is a situation where significant reduction in complexity could be achieved by eliminating a largely redundant provision.

Contribution to Simplicity

Treasury regulation section 1.401-4(c) should be eliminated and, therefore, plan designs would be simplified.

AICPA Tax Simplification Recommendation

SIMPLIFY THE DISTRIBUTION OF QUALIFIED PRE-RETIREMENT SURVIVOR ANNUITY (QPSA) NOTICES

Present Law

Under current law, certain plans must provide each participant, within a certain period, a written explanation with respect to the qualified pre-retirement survivor annuity option. The period during which the notice must be given is defined in section 417(a)(3)(B)(ii)(I) as the period beginning with the first day of the plan year in which the participant attains age 32 and ending with the close of the plan year preceding the plan year in which the participant attains age 35.

Suggested Change

The QPSA notice should be required to be provided only to individuals within a reasonable period after they become plan participants.

There is little logic in providing this notice only at the current age range, since most employees are sophisticated enough to understand the notice at any age. This provision has simply resulted in an increased compliance burden for plan sponsors without a commensurate return, either in understanding on the part of the participants, or in achieving effective disclosure.

Contribution to Simplicity

This would result in the repeal of section 417(a)(3)(B)(ii)(I).

AICPA Tax Simplification Recommendation

ELIMINATE THE ACTUAL DEFERRAL PERCENTAGE TEST IN CASH OR DEFERRED ARRANGEMENTS

Present Law

Section 401(k)(3) provides that the amounts deferred by highly compensated employees cannot exceed a multiple of the amounts deferred by nonhighly compensated employees. Specifically, the actual deferral percentage of the highly compensated employees cannot be either more than 125% of the actual deferral percentage of the nonhighly compensated employees or more than twice the actual deferral percentage of the nonhighly compensated employees with a differential of no more than 2 percentage points.

The Service has issued regulations explaining how to test employee elective deferrals for discrimination. Employer contributions may in some circumstances be used to help satisfy the actual deferral percentage test. In addition, certain matching contributions may also be used to help satisfy the discrimination tests. If the employer cannot afford, or does not wish, to make employer contributions to help satisfy the test and the tests have not been met by plan year end, the emloyer may recharacterize or distribute the excess deferrals. Penalties leading up to plan disqualification are imposed if the excess 401(k) deferrals are not distributed or recharacterized in a timely fashion. The Service has issued notices and regulations explaining when, and to what extent, deferrals may be distributed or recharacterized.

Suggested Change

The actual deferral percentage test of section 401(k) was enacted at a time when highly compensated employees could elect to defer up to $30,000 annually under a section 401(k) plan. It is aimed at preventing a 401(k) plan from discriminating against lower compensated employees, and operates to supplant section 401(a)(4). The potential for discrimination in a 401(k) plan has been dramatically reduced by the lowering of the elective deferral limitation in TRA 86 to $7,000, (indexed for cost of living). The performance of the actual deferral percentage test is time consuming for a plan of any significant size and many plan sponsors have not accurately tested on a timely basis.

The section 401(k) rules should be amended: 1) to require that all employees with a requisite age and year(s) of service and not in excluded categories under section 410(b) be permitted to make deferrals under an employer's 401(k) plan, and 2) the actual deferral percentage test be repealed.

Contribution to Simplicity

Code section 401(k)(3), section 4979 and the regulations and notices promulgated thereunder would be eliminated. Section 402(g)(1) would be modified to reflect a lower limit and the section 401(g)(5) adjustment for cost-of-living would remain in effect.

AICPA Tax Simplification Recommendation

EXPAND THE COVERAGE RULES FOR SECTION 401(k) PLANS TO INCLUDE EMPLOYEES OF TAX-EXEMPT ORGANIZATIONS AND ELIMINATE THE SEPARATE RULES IN SECTION 403(b)

Present Law

A 401(k) plan is not treated as a qualified 401(k) plan if it is part of a plan maintained by any tax-exempt organization or a state or local government or political subdivision thereof. On the other hand, a separate provision (section 403(b)) applies only to certain tax-exempt and charitable organizations and allows employees of these organizations to participate in arrangements which involve cash or deferred elections.

Suggested Change

It is difficult to understand why tax-exempt organizations are prevented from making salary deferrals available under section 401(k), and yet can make salary deferral elections available in an even more liberal fashion under section 403(b).

In addition, there appears to be no compelling policy justification for requiring employees of tax-exempt organizations to participate in annuity contracts or custodial accounts rather than in the investments available to employees of non-tax-exempt organizations. The repeal of section 403(b) should be considered. In an age where self-directed accounts are very commonly available through any of the large, national brokerage firms or other financial institutions, individual accounts are relatively easy to establish, not very costly, and much more convenient for employees of tax-exempt organizations than when section 403(b) was enacted.

In order to simplify the Code, tax-exempt organization employees should be treated the same as all other employees for salary deferral purposes. Thus, employees of both types of organizations should participate in identical plans, have the same salary deferral amount as a ceiling, and have the same plan investment alternatives available to them. This proposal, when combined with the previous proposal concerning section 401(k) plans, would provide for a uniform set of rules which could easily be administered by plan sponsors and the IRS.

Contribution to Simplicity

This would have effect of repealing section 403(b) and extending the 401(k) plan rules to employees of tax-exempt organizations.

AICPA Tax Simplification Recommendation

ELIMINATE THE ABILITY OF EMPLOYEES TO MAKE AFTER-TAX CONTRIBUTIONS TO QUALIFIED RETIREMENT PLANS

Present Law

If a qualified retirement plan permits, employees may make voluntary after-tax contributions to the plan. For plan years beginnning after 1986, these voluntary after-tax contributions count on a dollar-for-dollar basis against the limits of section 415(c). Additionally, a qualified plan that allows after-tax employee contributions is subject to a nondiscrimination test under section 401(m) that is similar to the nondiscrimination test in section 401(k). The nondiscrimination tests of section 401(m) were enacted because of the fear that voluntary after-tax employee contributions are utilized primarily as a tax-deferred savings vehicle for the highly compensated.

Suggested Change

The ability of a qualified plan to accept voluntary after-tax employee contributions should be eliminated and section 401(m) should be repealed. The rationale is one that is motivated solely by a desire for reducing complexity.

Allowing after-tax employee contributions to be made to qualified plans now requires plan administrators to separately account for these amounts annually to ensure that the tests of section 401(m) are met. These amounts must be separately identified when distributed to participants and involve a separate subset of rules in the distribution area to determine what is taxable to a participant and what is a recovery of the participant's basis. These rules are complicated both from a technical and a plan administration perspective.

The elimination of voluntary after-tax contributions would not only reduce complexity in the statute but would also reduce complexity in the administration of qualified plans. Adoption of this proposal would not leave employees without tax-deferred investments because Individual Retirement Accounts (IRAs) on a non-deductible basis under section 408(o) (which were not available until tax years beginning after 1986), tax-deferred annuities, and other investment products such as municipal bonds are offered in this category. Further, the existence and rapid acceptance nationally of pre-tax deferrals in 401(k) plans has made the after-tax contribution a less attractive alternative for employees.

If Congress decides that employees should be allowed to fund larger tax deferred savings accounts for their retirement by using after-tax contributions, the existing rules for IRA after-tax contributions could be amended to increase the allowable level of contribution.

With section 401(m) repealed, matching contributions would be subject to the nondiscrimination principles in section 401(a)(4). The statute could provide that if matching contributions are available at the same rate for all employees, the matching contributions would be deemed to be nondiscriminatory.

Contribution to Simplicity

The following Code sections governing plan qualification can be repealed if voluntary after-tax employee contributions are eliminated: sections 401(a)(19), 401(m), 411(c) and 411(d)(5). In addition to reducing complexity in the qualification area, the elimination of voluntary after-tax employee contributions will reduce complexity in the area of distribution planning and the taxation of distributions. For example, if voluntary after-tax employee contributions are repealed, the portion of section 72 which deals with the recovery of the employee's basis could be eliminated, section 402(a)(5)(B) could be repealed and the second sentence of section 402(a)(1) could be repealed. A transitional rule could be provided to facilitate the distribution of existing voluntary after-tax contributions from qualified plans. For example, participants could be allowed to transfer these amounts, with or without earnings, to an IRA.

AICPA Tax Simplification Recommendation

ELIMINATE THE PERMITTED DISPARITY RULES (SOCIAL SECURITY INTEGRATION RULES)

Present Law

TRA 86 substantially amended the Social Secrutiy integration rules. For example, in an integrated qualified plan, it is no longer possible to deny a participant a benefit accrual or contribution just because the plan is integrated with Social Security.

The new rules permit a certain amount of disparity for defined contribution plans by requiring that the excess contribution percentage (the contribution percentage with respect to compensation above the integration level) may not exceed the base contribution percentage (the contribution percentage with respect to compensation below the integration level) by more than the lesser of:

a. the base contribution percentage; or

b. the greater of
  (1) 5.7%; or

  (2) the percentage equal to the section 3111(a) tax rate attributable to old-age insurance.

This is the third set of defined contribution integration rules for plan sponsors within the last six years. Further, the IRS issued Notice 89-70 which supplements the above rules by reducing the permitted disparity for certain plans where the integration level is less than the Social Security wage base.

Similarly, defined benefit plan integration rules require that, for non-offset plans, the excess benefit percentage (computed in the same manner as defined contribution plans except that it is for benefits attributable to employer contributions, not contributions) cannot exceed the base benefit percentage by more than the maximum excess allowance, benefits be based on average compensation, and any optional forms of benefit be provided with respect to compensation below the integration level. The maximum excess allowance is equal to 3/4% for benefits attributable to any year of service with the employer, and, for total benefits, is equal to 3/4% times years of service up to 35 years. The 3/4 percent is further reduced, pursuant to Notice 89-70 for certain plans where the integration level is less than covered compensation.

The recent regulations and the supplemental notice implementing the TRA 86 rules have been widely criticized as being very complicated.

Suggested Change

The concept of permitted disparity should either be altogether eliminated or substantially simplified. A complete repeal of permitted disparity rules would reduce the complexity of the qualified plan area and would generally provide greater benefits to employees in those plans currently using the permitted disparity rules. Repeal of the disparity rules could, however, lead to termination of existing plans. Therefore, if complete repeal is not desired, the rules should be simplified. For example, the pre-TRA 86 rules could be reinstated with a minimum benefit required for all plan participants.

Contribution to Simplicity

This proposal would repeal sections 401(1), 401(a)(5) and 401(a)(15).

AICPA Tax Simplification Recommendation

SIMPLIFY THE COMBINED PLANS LIMITATIONS OF SECTION 415(e) AND REPEAL SECTION 4980A

Present Law

Where an employee of the same employer is covered by a defined benefit and a defined contribution plan, section 415(e) imposes a limitation that prevents an employee from accruing the maximum benefits otherwise allowable under under both the defined contribution and the defined benefit plan. Section 415(e) requires a calculation of a defined benefit fraction and a defined contribution fraction the sum of which may not exceed 1. These fractions are based on the benefits allowed by law. In some cases, these calculations require yearly monitoring. In other cases, the section 415(e) result is not know until an employee terminates employment or retires.

Section 4980A, enacted by TRA 86, places a 15% excise tax on certain distributions that exceed $150,000 a year or lump-sum distributions that exceed $750,000 a year. These rules diminish the value of large accumulations within qualified plans even though the section 415(e) limit may have been followed in the past.

Suggested Change

Employees who are benefited by a defined benefit and defined contribution plan of the same employer should be subject to either section 415(e) or section 4980A but not both.

If section 415(e) is to be retained, then section 4980A should be repealed. If section 415(e) is retained, it should be revised to be based on a plan design approach rather than on an actual accrued benefit approach. For example, if 100% of the defined benefit plan limit is being accrued for an individual, then only 25% of the maximum defined contribution limit would be provided for an individual under a defined contribution plan. (These percentages are used for illustrative purposes only.) This would eliminate the need for the annual cumulative calculation that is required under current law.

If, however, section 4980A is maintained in the law, then section 415(e) should be repealed and the maximum benefit should be allowed to accrue in both defined benefit and defined contribution plans.

We believe that the better course of action is to repeal section 4980A.

Contribution to Simplicity

The simplification achieved is the repeal of either section 415(e) or section 4980A.

AICPA Tax Simplification Recommendation

SIMPLIFY THE COVERAGE RULES BY REPEALING THE SECOND PART OF THE AVERAGE BENEFITS TEST

Present Law

Section 410(b) provides two ratio tests and an average benefits test; one of these three tests must be satisfied by a plan if it is to satisfy the coverage tests and qualify under section 401(a). The average benefits test is a two part test: 1) a fair-cross-section test comparable to pre-TRA 86 rules, and 2) the average benefit test which provides that the average benefit for nonhighly compensated employees must be at least 70% of the average benefit for highly compensated employees. A benefit percentage must be calculated for each employee and all benefit percentages within the two groups then averaged. The benefit percentage is the employer-provided benefit divided by compensation.

Regulations explaining average benefits have not been issued. Temporary regulations have been issued that provide percentage safe harbors, based on coverage, for the fair-cross-section test part of this test.

Prior to TRA 86, there were two ratio tests and a fair-cross-section test, but the fair-cross-section test did not have an average benefits test. Guidance on the fair-cross-section test was found primarily in revenue rulings. The fair-cross-section was a subjective test with no safe harbors.

Suggested Change

The average benefits test should be repealed. Section 410(b) is designed to test coverage and not benefit accrual. There are other sections of the Code that deal with nondiscrimination in benefit accrual and that concept should not be tested with coverage. This approach adds complexity and substantially overlaps with other requirements of the law such as 401(a)(4).

An alternative approach would be to confirm the section 401(a)(4) test to the section 401(b) test by statute so employees would have a uniform set of values to apply.

Contribution to Simplicity

The simplification achieved is the repeal of the average benefits test found in section 410(b)(2)(A)(ii).

AICPA Tax Simplification Recommendation

APPLY SECTION 404(a)(1) ONLY TO DEFINED BENEFIT PLANS

Present Law

Section 404(a)(1) currently limits the amount deductible for contributions to pension plans. Pension plans include defined benefit plans and money purchase pension plans, a form of defined contribution plan.

Suggested Change

Given the earlier proposal to classify all plans as either defined benefit or defined contributions plans, section 404(a)(1) would only apply to defined benefit pension plans.

Contribution to Simplicity

The reduction in complexity achieved would be the consistent treatment of money purchase pension plans throughout the Code.

AICPA Tax Simplification Recommendation

APPLY SECTION 404(a)(3) TO ALL DEFINED CONTRIBUTION PLANS

Present Law

Section 404(a)(3) limits the amount deductible for contributions to profit-sharing plans and stock bonus plans.

Suggested Change

Section 404(a)(3) should limit the deduction for all types of defined contribution plans instead of for just profit-sharing and stock bonus plans. After this change, the deduction limit for money purchase plans would be found in section 404(a)(3). A further simplification is the coordination between the 15% deductibility limit in 404(a)(3) and the 25% contribution limit in section 415(c). The section 415(c) and section 404(a)(3) limits would be the same, for example, 25% of compensation.

Contribution to Simplicity

Again, one set of terms would be used consistently throughout the Code. This proposal would also eliminate the necessity of maintaining two plans, a money purchase pension plan and a profit-sharing plan to achieve the maximum level of contribution allowable under law for defined contribution plans, while retaining maximum flexibility.

AICPA Tax Simplification Recommendation

REPEAL FIVE YEAR AVERAGING FOR DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS

Present Law

An individual can receive his or her entire balance from a qualified plan in one year and elect five-year averaging. Five-year averaging in certain situations lowers the tax that would otherwise be paid if the entire distribution were to be included into income in one year.

Suggested Change

The proposal is that five-year averaging be repealed. Lump-sum distributions would be included in income in the year received and taxed as ordinary income unless rolled over into an IRA.

Congress has become increasingly concerned that retirement plan balances are being used to fund expenditures unrelated to retirement, e.g. venture capital. Studies indicate that lump-sum distributions are often depleted by the time an employee reaches retirement age. Repeal of favorable tax treatment is intended to encourage using retirement funds to pay for living expenses upon retirement. This would also simplify decision making for plan participants at retirement by eliminating one of the current taxation alternatives.

It is not recommended that lump-sum distributions from plans be prohibited because of the administrative convenience of paying an employee's balance, especially smaller sums, upon termination of employment. What would be eliminated would be preferential tax treatment if the distribution were not rolled over into another qualified plan or IRA.

Contribution to Simplicity

Repeal of five-year averaging would eliminate the following Code sections: 402(e)(1), (2), (3), 402(e)(4)(B), (C), (D), (G), (H), (M) and (O).

AICPA Tax Simplification Recommendation

ALLOW THE ROLLOVER OF ANY DISTRIBUTION FROM A QUALIFIED PLAN, OTHER THAN REQUIRED MINIMUM DISTRIBUTIONS

Present Law

Section 402(a)(5)(D) allows for the rollover of partial distributions into IRAs. To qualify as a partial distribution, the distribution must be at least 50% of the account balance of the participant and must be payable because of death, separation from service or disability. This provision was enacted as part of the Deficit Reduction Act of 1984 (DEFRA). Prior to DEFRA, only total distributions could be rolled over. Congress enacted this provision so that rollovers could still be allowed even though a participant inadvertently received less than the total plan balance. It is not clear why a 50% threshold was chosen, particularly since current law allows any portion of an otherwise "qualifying" distribution to be rolled over even if it is less than 50% of the distribution.

Suggested Change

Any distribution from a qualified plan should be eligible to be rolled over into an IRA except for distributions pursuant to section 401(a)(9). This would simplify distribution planning and encourage retention of funds originally contributed to retirement plans for retirement. It would also eliminate the disparity between the amount required to be distributed to be eligible for a rollover and, at the option of the recipient, the lesser amount which is permitted to be rolled over.

Contribution to Simplicity

Section 402(a)(5)(D) would be repealed and the definition of a qualified total distribution would no longer be necessary.

AICPA Tax Simplification Recommendation

SIMPLIFY THE MINIMUM DISTRIBUTION RULES OF SECTION 401(a)(9)

Present Law

Section 401(a)(9) provides for the systematic distribution of qualified plan and IRA benefits over an individual's and beneficiary's life expectancy beginning at age 70 1/2.

Suggested Change

The minimum distribution rules are aimed at preventing plan participants from using qualified retirement plans as estate planning devices. With the repeal of the estate tax exclusion in DEFRA for qualified plan interests, a strong argument can be made for the repeal of section 401(a)(9). However, even after DEFRA, participants could still receive a significant tax advantage by deferring the receipt of their benefits to a date in the distant future.

Two changes can be made to simplify section 401(a)(9) without compromising the purpose of the provision. First, at death, distributions could be required to be paid over the life expectancy of the beneficiary beginning at the decedent's death. There would be no distinction between situations where an individual dies before or after his required beginning date. There would also be no distinction between types of beneficiaries as there is under current law. Second, the calculation of life expectancy should not be recalculated. The only method of determining life expectancy would be reducing the initial calculated life expectancy by one each year. Both of these suggestions are intended to streamline section 401(a)(9) without altering the underlying concept. Finally, consideration should be given to reducing the number of participants to whom this rule applies by limiting its application to participants with accrued benefits in excess of a certain level.

Contribution to Simplicity

Section 401(a)(9)(B) would be condensed from four rules for distributions upon death to one rule. The regulations would be simplified concerning the calculation of life expectancy.

AICPA Tax Simplification Recommendation

SIMPLIFY HARDSHIP WITHDRAWALS FROM 401(k) PLANS

Present Law

Under current law, hardship withdrawals based on need can be made from cash or deferred arrangements under section 401(k). However, such distributions are subject to a 10% additional income tax under section 72(t) if the distribution is made prior to age 50 1/2, with some exceptions.

Suggested Change

The rules governing hardship distributions from qualified plans could be substantially simplified by specifying certain situations in the statute which would be considered a hardship for distribution purposes, e.g., purchase of a principal residence, education, or medical expense. In addition, no suspension from plan participation would be imposed on account of a hardship withdrawal.

An alternative to simplification would be elimination of hardship withdrawals. Elimination of hardship withdrawals, however, might discourage nonhighly compensated employees from participating in section 401(k) plans.

Contribution to Simplicity

The complicated plan amendments required as a result of the proposed and final regulations on hardship withdrawals in 401(k) plans which were issued on August 8, 1988 would no longer be needed and the role of plan administrators in administering affected 401(k) plans both now and in future years would be simplified.

AICPA Tax Simplification Recommendation

BETTER DEFINE THE TERMINOLOGY USED IN SECTIONS 414(m) AND 414(n) AND REPEAL SECTION 414(o)

Present Law

Section 414(m) provides rules which treat all employees of members of affiliated service groups as employed by a single employer for certain qualified retirement plan purposes. In general, there are two sets of rules in section 414(m): affiliated service group rules and management group rules.

Section 414(n) provides similar rules concerning certain leased employee arrangements.

Section 414(o) provides a broad grant of regulatory authority for the IRS to deal with business arrangements which would allow for circumvention of the qualified plan requirements.

Suggested Change

The section 414(m) affiliated service group definitions under the Code and the regulations are extremely complex. If Congress wishes to prevent the perceived abuse at which section 414(m)(2) was aimed, it appears that much of the complexity would have to remain. However, it would be helpful if some of the terms used in the Code were more clearly defined. The use of too many qualitative terms causes plan sponsors and their advisors to spend extra time and effort in attempting to interpret them.

First, the definition under section 414(m)(2)(A)(ii) could be changed to state that "if more than 25% of the services performed by the A organization are for the first service organization" instead of using the amorphous term of "regularly performed." Also, de minimis ownership should be ignored under section 414(m)(2)(A)(i), e.g. ownership of less than 1%. Under the B organization definition, the phrase "significant portion" should be defined as 25% or more.

With respect to section 414(m)(5), the "principal business" should be defined in the Code as the business constituting 50% of gross revenues. In addition, firm management functions should be defined as executive type functions rather than permitting the regulations to expand that definition to include professional services. Simply rendering professional services for another organization should not cause the individual providing the service to be aggregated with the recipient organization on that basis alone.

Section 414(n) is a fairly straightforward Code provision aimed at abusive situations where employers do not employ their own employees, but rather lease employees from a third organization. This provision should be clarified so that it does not cover independent contractors where there is no third party leasing organization involved. Also, it would be helpful if the reference to section 144(a)(3) under section 414(n)(6) were eliminated as it makes analysis under this Code provision extremely difficult.

Finally, section 414(o) should be eliminated entirely as it has made it virtually impossible for a sole proprietor and other small businesses to determine eligibility for pension plan contributions when it is involved in any way with any other entity. For example, an employee who is a 5% owner of a company and who also works for another company must determine whether the two companies are recipients under section 1.414(n)-1(b)2 and (b)(6), which in turn, requires an analysis under sections 414(b), (c) (m), and (o) and also under section 144(a)(3), and with respect to any organization under sections 414(b), (m), and (o) and section 144(a)(3) requires an analysis of whether there is aggregation under sections 267, 707(b) or members of controlled groups as defined in section 1563 substituting 50% for 80%. This analysis is beyond the ability of most sole proprietors (and many practitioners), and would probably cost more in advisor's fees than what many sole proprietors would gain by taking the pension plan deduction.

Contribution to Simplicity

Making the statute more specific will assist plan sponsors and their advisors in interpreting and applying these provisions.

AICPA Tax Simplification Recommendation

ALLOW EMPLOYERS TO CHOOSE AN IRS PROTOTYPE IF THEY WANT A QUALIFIED RETIREMENT PLAN

Present Law

Recent tax laws have liberalized section 408(k), the simplified employee pension (SEP), which allows a maximum of 15 percent of compensation and requires coverage for employees earning at least $300 in three out of five years. However, employers desiring a contribution rate of 25 percent of compensation, or those who could benefit from a regular plan's 1000-hour participation requirement choice of vesting schedules, or those desiring a defined benefit plan, must deal with onerous and expensive compliance requirements.

Rapid tax law changes have required frequent revisions in every qualified plan. This has been especially burdensome for small employers.

Suggested Change

A provision for an employer qualified pension (SEQP) should be enacted. It would:

1. Establish a new IRS prototype plan. It should be as simple to adopt as completing the Form 5305-SEP or 5305A-SEP used to adopt a simplified employee pension plan. Once adopted, it will automatically be updated for future changes in the law and the employer will be bound by the prototype changes.

2. The plan year would be the employer's fiscal year. The maximum wage base would be $200,000.

3. Allow an annual variable contribution of up to 15 percent of compensation.

4. Allow an election for a fixed contribution of an additional zero to ten percent. Fixed contributions would be commingled with the variable contributions into a single plan. The employer could terminate the fixed contribution election, but he could not re-elect it for five years.

5. Set an eligibility standard not to exceed age 21. Set a participation standard more restrictive than SEP's $300, which does not impose a recordkeeping burden like calculating 1,000 hours (e.g., minimum wage at the beginning of the plan year multiplied by 500).

6. Allow a binding election of 2 years/20 percent, 3 years/100 percent, or faster vesting. The election could be changed upon obtaining IRS approval.

7. A salary reduction option would be permitted, modelled after a SEP.

8. Plan distributions would be made only to an employee's IRA account.
9. Loans would not be permitted. But an employee could request that any vested portion be transferred to his IRA within 30 days of receiving his annual statement.

10. Investments would be restricted to assets allowed to IRA's and which are readily subdivided for distribution.

Defined benefit plans and social security integration would not be features of SEQP. A simplified method should be provided for existing plans to change to a SEQP.

SEQP could be enacted as a new provision, or by expanding SEP provisions.

Contribution of Simplicity

With recent tax reform, an employer's ability to discriminate and tailor retirement plans has been greatly restricted. Frequent tax law changes provide no perceptible improvements for employers other than expensive compliance costs.

In an effort to reduce legal fees, many attorneys are devising prototype and master plans for their clients. Many employers have plans through brokerage houses, insurance companies, and banks. Employers often receive poor advice and wind up with multiple profit sharing and money purchase plans as a result of signing plan documents with competing firms. When an employer changes lawyers or plan providers, his qualified plan is unfamiliar to the new provider. Unless he receives expert (and expensive) advice, his plan will not be properly updated. As a result, a very large percentage of existing plans are technically in violation of paperwork and update requirements of existing law.

SEQP should dramatically reduce costs to administer a qualified retirement plan. It should improve compliance because it will be simpler for employers to understand the rules. Plan updates for tax law changes would be automatic. It would reduce the administration burden on IRS.

AICPA Tax Simplification Recommendation

SHIFT BURDEN OF TRACKING THE BASIS OF INDIVIDUAL RETIREMENT ARRANGEMENTS FROM TAXPAYER TO ACCOUNT TRUSTEES

Present Law

A taxpayer who makes nondeductible contributions to an individual retirement arrangement (IRA) is required to report these contributions on Form 8606. This form must also be filed if IRA distributions are received or nondeductible contributions are made to the IRA(s). In completing this form, the taxpayer arrives at his or her basis in the IRA as of the end of the taxable year. The basis of the taxpayer's IRA(s) must be recompute in each subsequent year in which there are nondeductible IRA contributions or IRA distributions. Currently, under section 408(o), the taxpayer would average the aggregate taxable and nontaxable contributions when determining the taxable portion of distributions.

Suggested Change

The responsibility for the tracking of the basis of IRAs should be reassigned to the account trustee. Information on what portion of the IRA contributions were to be considered nondeductible would be furnished to the trustee by the taxpayer or the Internal Revenue Service at the time the tax return was filed or adjusted. In the absence of timely notice to the contrary, the item will be considered as a deductible contribution. It might be desirable to set up separate IRAs for deductible and nondeductible contributions. Where multiple IRAs exist, the order of the distributions could be specified.

Contribution to Simplicity

This change would result in reducing the administrative burden for a large class of taxpayers who do not normally need to keep track of the tax basis of assets. Account trustees generally have the expertise and data management capabilities to comply accurately with recordkeeping requirements. Parity in the tax treatment of IRAs and pension plans would be enhanced.

Other Issues

Second order effects may include an increase in the tangible costs of administering these arrangements offset by the less tangible savings in the paperwork burden imposed on individual taxpayers. To the extent that taxpayers perceive IRAs to be more costly, this type of savings may decrease. Alternatively, the current recordkeeping required of the individual taxpayer may result in a shift to other forms of savings. This suggestion would change the current averaging rule for IRA distributions.

AICPA Tax Simplification Recommendation

SIMPLIFY THE "PARTIAL DEDUCTION" OF IRA CONTRIBUTIONS

Present Law

Deductions for contributions to individual retirement arrangements (IRAs) are generally permitted in computing adjusted gross income (AGI). However, the deduction is conditioned upon whether the taxpayer or the spouse is covered by an employer-funded retirement plan. If the taxpayer or spouse is deemed to be an active participant in such a plan, the deduction is allowed in full under IRC section 219(g) only if the modified adjusted gross income is $40,000 or less on a joint return (or that of a surviving spouse). The "modified AGI threshold" is $25,000 if the taxpayer files as single or head of household and $0 if the taxpayer is married and filing separately. A partial deduction is calculated if modified AGI is over $40,000 and does not exceed $50,000 on a joint return (between $25,000 and $35,000 on a single return and between $0 and $10,000 on a separate return).

Suggested Change

If the taxpayer or the spouse has had a contribution for his/her benefit made to an employer retirement plan and the taxpayer's(s') modified AGI exceeds the "modified AGI threshold," a partial deduction would be computed with a dollar-for-dollar phaseout of the deduction for each dollar of modified AGI in excess of the threshold. A full deduction up to the allowable amounts (the lesser of $2,000 or $2,250 or earned income or the amount of the actual contribution) would continue to be allowed if the taxpayer's modified AGI is less than the "modified AGI threshold." A full deduction up to the allowable amounts would also be allowed if the taxpayer and spouse, if married, has not had a contribution for his/her benefit made to an employer retirement plan (regardless of whether the taxpayer or spouse is covered by an employer retirement plan or deemed an active participant).

Contribution to Simplicity

Currently, complex calculations are required for a number of middle class taxpayers whose modified AGI falls within the a $10,000 range above the stipulated threshold amounts. The proposed dollar-for-dollar phaseout of the deduction would simplify the computations required in filing a tax return.

Other Considerations

If the dollar-for-dollar phaseout replaces the current $10,000 range, without an upward adjustment to the threshold amounts, two results (or a combination thereof) may occur: (1) the aggregate amount of tax-deductible IRA contributions will be reduced while the corresponding aggregate nondeductible IRA contributions will be increased, which will result in additional tax revenue; and/or (2) there will be a decrease in contributions to this type of savings plan. If Congress wishes to retain the benefit of the average partial deduction under the current system, the thresholds could be increased above $40,000 (or $25,000 or $0). Raising these thresholds would also reduce the number of taxpayers subject to the phaseout calculation.

Chairman **Pickle**. Well, let me pursue that point at this stage. I must step out of the room, and I will let Mr. Anthony take the chair for a moment, but let me say to you, you agree with the limited scope, and you agree with the training, and you are very progressive and forward moving in that area. You have some question about compliance, but you have also said that you would be glad to work with us if we insist on it.

Now, in the civil tax penalty measure, we did include a statement with respect to a peer review, at least the tax preparer would have to have a reasonable belief that that was a proper approach to take.

You helped us reach an agreement in that area to that extent, and perhaps if we approach this measure as we did in the roundtable on the tax penalty bill, we might find some common ground. I hope we can do that. I can understand the reservation you would have about a strict compliance audit because you need a lot more compliance laws. You don't need a lot more tax penalties, but perhaps we could find some common ground in there. And I would like to explore that with you, and we will be doing it.

I might say to you and to Mr. Hoffman both, perhaps we may use the roundtable discussion, we are considering that approach now with respect to the tax gap, and this might be an area that would be ideally suited for consideration in this overall approach. We may do that.

So I thank you for your testimony.

Mr. **Hoffman**. Thank you.

Chairman **Pickle**. Now we will ask David Davis representing the ERISA Industry Committee.

Mr. Davis.

STATEMENT OF DAVID M. DAVIS, PRACTICE AREA MANAGER, PERSONNEL AND LABOR RELATIONS, GENERAL MOTORS CORP., ON BEHALF OF ERISA INDUSTRY COMMITTEE

Mr. **Davis**. Yes. Good afternoon, Mr. Chairman and members of committee, my name is David Davis. I am employed as a practice area manager, personnel and labor section of the General Motors legal staff, and I speak to you as a representative of ERIC.

ERIC represents more than 120 of the Nation's largest employers concerned with national retirement and welfare benefit issues. As the sponsors of pensions, savings, health, disabilities, life insurance, and other welfare plans covering some 25 million participants and beneficiaries, ERIC's members share with the subcommittee a deep interest in the success and expansion of the employee benefit system in the private sector.

I will summarize the testimony that ERIC has submitted. The vast majority of plans today are well funded and well managed. We suggest that a second savings and loan crisis is not brewing here. The vast majority of plans are operating soundly, and there is no reason to believe that participants are in any danger of losing their benefits.

Over the past decade Congress has produced complex and highly technical rules and regulations. These regulations have increased the cost of plan administration. Such costs could be better spent in providing benefits to participants.

The Internal Revenue Service Commission, Assistant Commissioner Brauer, indicated that 15 changes in the law have occurred since the enactment of ERISA. Complex rules and regulations have created confusion and apprehension among participants and have discouraged the formation and continuation of benefit plans.

This is evident from the shift from defined benefit plans to simpler defined contribution plans. A retreat from defined benefit plans threatens the viability of the Pension Benefit Guaranty Corporation.

The inability of the Department of Labor and the Internal Revenue Service to move more rapidly in issuing regulations under the constantly changing statutory provisions has compounded the problem.

This may well not be the fault of the agencies, but may be because of the significant amount of legislation that has been enacted.

I think we should consider increasing the resources available to the Federal agency charged with the enforcement and administration of ERISA. It may be also timely to examine who administers ERISA in the Federal Government.

ERIC is willing to cooperate with this subcommittee in considering a fundamental restructure of the agency's responsibilities. We suggest that criminal and civil remedies are adequate.

The Department of Labor, the Internal Revenue Service, and the Department of Justice have available to them a broad array of criminal and civil sanctions to enforce ERISA. Criminal sanctions exist for theft, embezzlement, bribery, kickbacks, fraud, failure to comply with reporting and disclosure provisions, and coercive interference with the exercise of rights under ERISA.

In the civil area, there are fines, penalties, severe tax consequences for violations of ERISA reporting and disclosure provisions, funding and fiduciary standards, participation, vesting and accrual requirements.

John Keeney from the Department of Justice confirmed that he saw no need for additional penalties in civil and criminal areas. This was also confirmed by Ray Maria.

Numerous reports document the ineffectiveness of the current enforcement. For example, in 1986, the Senate Oversight and Government Management Subcommittee observed in part, ERISA enforcement has not been a high priority with the Federal Government.

The Department of Labor implementation of ERISA has been characterized by inadequate resources, frequent changes of leadership, and shifting enforcement strategies.

Inadequate training of Department of Labor employees have exacerbated the problem. ERIC strongly suggests that all these deficiencies should be addressed and remedied before new burdens are imposed on plan sponsors.

Plan sponsors should not be faced with new litigation costs, unnecessary and superfluous auditing, recordkeeping and testing requirements.

Such requirements increase cost upon plan sponsors. Those moneys can be better spent on benefits.

The DOL proposals, and I will go over them in particular, do nothing to remedy the problem relating to professional criminals described by Ray Maria.

The DOL proposes mandatory attorney fees and costs. ERISA already grants authority to the courts to award attorney fees and costs as they determine appropriate.

In our experience, courts have not been reluctant to award such fees and costs to plaintiffs when circumstances warrant. There is no reason to institute an inflexible rule which will lead to unjust and inappropriate results.

Incentives to increase private litigation is not the answer. This will only increase costs of maintaining benefit plans. Litigation is a costly, inefficient and haphazard way of assuring that plans are appropriately administered.

Experience in other areas, for example, in medical malpractice, has demonstrated that private civil litigation can disrupt the provision of services and in fact become part of the problem.

ERIC strongly opposes the suggestion of the Department of Labor that a de novo review be provided unless an independent party is the final arbiter of the claim.

All plans today are required to maintain appeal procedures. Most employers have established internal committees consisting of members familiar with plan terms and provisions to review denied claims. Such a committee ensures that the administration is consistent with the employer's intent in establishing the plan.

Such determinations by that committee of expertise should be given deference by the courts. If such administration is done by an outside party, employers will be less likely to establish plans and provide benefits.

Further, many benefits are provided at the discretion of employers in favor of employees. Such discretion will be eliminated if we subject these plans to a stringent de novo review.

Although the Department of Labor is not suggesting punitive damages be awarded under ERISA, others have made that suggestion. There has been no showing of the kind of abuses to justify such draconian legislation.

The prospect of potential punitive damages will only encourage more litigation and further discourage the establishment and continuation of plans.

Money spent on litigation defense are moneys that cannot be applied to benefits. The Department of Labor has proposed increasing the excise tax rate on prohibited transactions from 5 to 10 percent. ERIC would point out that ERISA's prohibited transaction provisions are intricate and complex.

Attorneys representing ERIC members spend countless hours attempting to identify party in interest transactions and, when identified, determining whether such transactions are prohibited transactions.

The proposed increase in the rate ignores the fact that the 5 percent penalty applies annually until the transaction is corrected, and that 100 percent penalty applies if the prohibited transaction is not timely corrected.

It ignores the fact that fiduciaries are personally responsible to reimburse the plan for losses and that any profits realized by the fiduciary must be remitted to the plan.

If there is a problem in this area, it is that sanctions are too severe and too mechanical. The intent of the fiduciary is irrelevant. An inadvertent violation is punished just as severely as an intentional willful violation of the prohibited transaction provisions.

The simplistic suggestions to raise the rate ignores the inappropriateness of applying a severe mechanical penalty to inadvertent violations of complex and ambiguous statutory provisions.

The DOL suggestion to eliminate the limited scope audit exemption and institute a provision allowing the single audit approach is sound. ERIC supports this proposal.

Also, we would suggest that in order for this proposal to be effective, it should be applied to all plans, including those plans with fewer than 100 participants.

The Department of Labor has decided not to suggest a compliance audit. ERIC would agree and would suggest that because of the intricate, confusing, and often subjective rules governing employee benefit plans, a required compliance audit is neither necessary nor feasible, and it may well take the accountant outside of his expertise in attempting to render opinions.

The basic issue, in summary, is I think we should suggest that before recommending adoption of the DOL proposals, it is important for this subcommittee to carefully consider the basic issues.

In the ERIC testimony submitted at the end of this testimony, we included a list of questions, and I would suggest that it's important for this committee to focus on those questions. And I believe if you do so, it will demonstrate that the DOL proposals in the civil enforcement area are not sound.

I thank you for your time, and I would be happy to answer any questions.

[The prepared statement follows:]

STATEMENT OF DAVID M. DAVIS

ON BEHALF OF
THE ERISA INDUSTRY COMMITTEE

Mr. Chairman and members of the Subcommittee, my name is Dave Davis. I am Practice Area Manager, Personnel & Labor Relations, of the General Motors Corporation. I appear today on behalf of The ERISA Industry Committee, commonly known as ERIC. I serve as the Chairman of ERIC's Legal Committee. My remarks today represent the views of The ERISA Industry Committee.

ERIC

ERIC is an association of more than 120 of the Nation's largest employers concerned with national retirement and welfare benefit issues. As the sponsors of pension, savings, health, disability, life insurance, and other welfare plans covering some 25 million participants and beneficiaries, ERIC's members share with the Subcommittee a deep interest in the success and expansion of the employee benefit plan system in the private sector.

ERIC was particularly pleased to work closely with the Subcommittee and its Chairman and staff on the Pension Protection Act of 1987. The Pension Protection Act made major improvements in the pension funding standards and in the pension termination insurance program. ERIC remains committed to the continuation and growth of well-funded pension plans and to the security of the termination insurance program. We very much appreciate the efforts that the Chairman and the Subcommittee have made to achieve these objectives.

Comments

Voluntary Employee Benefit Plans. Major employers provide pension, health, disability, life insurance, and other important benefits to their employees through voluntary employee benefit plans. Although employers are not required to provide benefits to their employees, the estimated 700,000 voluntary employee benefit plans have been remarkably successful in delivering needed pension and welfare benefits to millions of employees and their families and dependents. As I mentioned, ERIC's members provide benefits to approximately 25 million Americans.

The vast majority of employee benefit plans are well-funded, well-managed, and entirely successful in delivering promised benefits to employees and their dependents. Although some media reports have suggested that a second "savings and loan" crisis is brewing here, we strongly disagree. The vast majority of employee benefit plans are operating soundly, and there is no reason to believe that a significant number of employees are in danger of losing their benefits.

Complex and Constantly Changing Laws. If there is anything fundamentally wrong with the employee benefit system today, it is the complex and constantly changing statutory and regulatory regime that has been imposed on employee benefit plans. Over the past decade, the Congress has produced a barrage of legislation affecting private-sector employee benefit plans. The legislation has --

- resulted in a multitude of highly technical and extremely complex rules and regulations,
- increased the cost of plan administration, thereby reducing the funds available to provide benefits to employees,

- created confusion and apprehension among plan participants,
- discouraged the formation and continuation of benefit plans, and
- shifted incentives away from defined benefit plans and toward defined contribution plans; as a result, the health and vitality of the nation's defined benefit system has been weakened. A retreat from defined benefit plans could threaten the financial condition of the Pension Benefit Guaranty Corporation.

The inability of the Department of Labor and the Internal Revenue Service to move rapidly to issue timely regulations under the complex and constantly changing statutory provisions has compounded the problem. Because the agencies have been slow to issue regulations under ERISA, plan sponsors have not had the guidance that they need to be certain that their plans comply with the statute, and have acted at their peril in making good faith efforts to comply with the law. When the agencies have issued regulations, the regulations frequently have been convoluted and impractical. At times, Labor Department regulations have been inconsistent with IRS regulations.

Administration of ERISA. We think it is timely for the Subcommittee to examine how the agencies administer ERISA. The Subcommittee can make an important contribution by considering whether it is appropriate to increase the resources that are allocated to the agencies or to change the current administrative structure.

We expect the Government to administer ERISA effectively and efficiently. If the Department of Labor and the Internal Revenue Service require additional resources or personnel to discharge their enforcement responsibilities, we would support the necessary appropriations. Similarly, we are willing to cooperate with the Subcommittee in considering a fundamental restructuring of the agencies' responsibilities. We are ready and willing to work with the Subcommittee to make the administration and enforcement of ERISA effective, efficient, and timely.

Current Criminal and Civil Sanctions. Under current law, the Department of Labor, the Internal Revenue Service, and the Department of Justice already have at their disposal a broad array of criminal and civil sanctions to enforce ERISA. The criminal sanctions include penalties for such conduct as theft, embezzlement, bribes, kickbacks, misrepresentation, concealment of facts, failure to comply with ERISA's reporting and disclosure obligations, and coercive interference with a participant's exercise of his rights under ERISA. The civil sanctions include fines, penalties, and severe adverse tax consequences for violations of ERISA's reporting and disclosure obligations, its funding and fiduciary responsibility standards, its participation, vesting, and coverage requirements, and the health care continuation and Medicare secondary payer provisions.

We believe that the Government should provide clear guidance, vigorously enforce the laws governing employee benefit plans, and use the full range of sanctions already at its disposal in appropriate cases.

Ineffectiveness of Current Enforcement Program. Numerous studies, however, have indicated consistently that the Government's enforcement efforts have been deficient. The

General Accounting Office's 1985 Report to the Senate Government Affairs Committee's Oversight of Government Management Subcommittee found that the overall effectiveness of the Labor Department's enforcement program had been criticized over the past ten years by the GAO itself, the Department's Inspector General, and the Labor Department's internal ERISA Enforcement Working Group. The GAO found that the Department's longstanding problems included (1) lack of a consistent long-term strategy, (2) limited coverage of plans due to a relatively small investigative staff, and (3) inadequate staff training.

In 1986, the Senate Oversight of Government Management Subcommittee made the following findings:

- ERISA enforcement has not been a high priority of the Federal Government;
- The Labor Department's implementation of the law has been characterized by grossly inadequate resources, longstanding deficiencies, frequently changing and inconsistent leadership, and shifting enforcement strategies;
- Inadequate training of the Labor Department's employees has exacerbated the problem;
- The Labor Department is far behind in processing the information reported annually by private plans;
- The Labor Department's process for reviewing prohibited transaction exemption requests is too slow and may result in lost investment opportunities for pension plans; and
- The Labor Department fails to follow up on referrals to the IRS for imposition of an excise tax on those who engage in prohibited transactions, and the IRS closes its files on many of the referrals without imposing an excise tax.

We believe that all of these deficiencies should be remedied before new burdens are imposed on plan sponsors. The Subcommittee and the Congress should not respond to deficiencies in the Government's administration of the law by imposing on the private sector new litigation costs and unnecessary and superfluous auditing, recordkeeping, and testing requirements. Like Section 89, such requirements place more costs and burdens on employers and plan administrators, impairing their ability to provide benefits to employees and their beneficiaries, and increasing their incentive to get out of the system.

Proposed Incentives for Private Litigation. We are concerned particularly about proposals that have been made to give private lawyers additional incentives to sue to enforce ERISA. Specifically, the Department of Labor has proposed that ERISA be amended to require the courts to award attorneys' fees and expert witness fees to a prevailing plaintiff in an ERISA suit. These proposals are not merely unnecessary; they will severely damage employee benefit plans and the millions of Americans who receive benefits from them.

ERISA already grants the courts broad statutory authority to award attorneys' fees and costs and to award any equitable or remedial relief that the court considers appropriate. In our experience, the courts are not reluctant to award attorneys' fees and costs to plaintiffs when the circumstances warrant. There is no reason to remove the court's discretion and to substitute an inflexible rule that is bound to lead to unjust and inappropriate results and to more litigation.

Giving lawyers additional incentives to sue also will significantly increase the cost of maintaining benefit plans. Employers will be required to budget, and allocate to litigation costs, funds that otherwise would be allocated to benefits. Litigation is a costly, inefficient, and haphazard way of assuring that plans are properly administered and that employees receive the benefits to which they are entitled. Experience in other areas, such as medical malpractice, has taught us that more litigation can disrupt the provision of services, and that it too often becomes a part of the problem.

De Novo Review. The Labor Department also has proposed that Congress require *de novo* judicial review of benefit claims cases unless an "independent party" is the final arbitrator of the claim. We strongly oppose this proposal. Most major employers appoint an internal committee that is familiar with the employer's benefit plans to serve as the final decisionmaker on all denied claims. Because the committee is familiar with the plan and with the employer's intent in creating the plan, the employer proceeds with confidence that the plan will be administered in a manner consistent with the employer's intent when it established the plan. If Congress enacts legislation that requires an outside party to resolve benefit claims under the plan, an employer -- who no longer will have confidence that the plan will be administered in accordance with the employer's original intent -- will naturally be less willing to establish a plan or to provide any benefits that require the exercise of discretion under the plan. Plans are more likely to be severely circumscribed by rigid benefit restrictions and/or limits on cash outlays to participants.

Punitive Damages. Although the Labor Department has not included a punitive damages provision in its proposal, others are urging the Congress to amend ERISA to authorize punitive damage awards. No showing has been made of any problems or abuses that justify draconian legislation of this kind. The prospect of potential punitive damages will only encourage even more litigation and discourage employers from sponsoring plans.

Mounting litigation costs will, at the very least, reduce an employer's ability to provide benefits. An employer has only a limited budget to devote to employee benefits. To the extent that an employer is required to spend more of that budget to defend lawsuits, it has less money left to provide needed benefits.

Health care costs, for example, are skyrocketing, and it is increasingly important for employees to have employer-provided health care coverage. It makes no sense to enact legislation that discourages employers from providing health benefits to their employees. Yet this is precisely the effect that these proposals will have.

Excise Tax Rate. The Department's proposal to increase the excise tax on prohibited transactions from five percent to ten percent is not supportable. ERISA's prohibited transaction provisions are at once intricate and obscure. Lawyers at ERIC's member companies spend countless hours trying to determine whether a particular individual or entity is a "party in interest" under ERISA's convoluted statutory definition and, if so, whether a proposed transaction with the party in interest is prohibited by ERISA's prohibited transaction provisions or exempted by either a statutory exemption or an administrative exemption issued by the Department of Labor.

The proposed increase in the five percent excise tax ignores the fact that the tax applies annually until the transaction is corrected, and not on a one-time basis; and it also ignores the fact that a 100 percent excise tax is imposed if the prohibited transaction is not timely corrected. As if this were not enough, current law already requires a fiduciary who has engaged in a prohibited transaction to restore any losses that the plan has incurred as well as any profits that the fiduciary has realized as a result of the prohibited transaction. These sanctions serve as powerful disincentives to engaging in anything that even looks like it might be a prohibited transaction. As I mentioned, ERIC's members spend very substantial amounts of time and talent trying to identify and avoid potential prohibited transactions.

If there is a problem with the current prohibited transaction provisions, the problem is that the sanctions are too severe and too mechanical. Under most of the prohibited transaction provisions, the fiduciary's intentions are irrelevant; an inadvertent violation of the prohibited transaction provisions is punished just as severely as a deliberate violation. Given the complexity and ambiguity of many of the prohibited transaction provisions, this is not sensible. Although it would be worthwhile for the Subcommittee to review the administration and enforcement of ERISA's prohibited transaction provisions, a simple increase in the five percent tax is unjustified. The Labor Department's proposal ignores the real problem: the inappropriateness of applying a severe mechanical penalty to inadvertent violations of a highly complex and often ambiguous statute.

Audit Requirement. The Department also has proposed the elimination of the "limited scope" audit exemption set forth in section 103(a)(3)(C) of ERISA and to substitute a provision that permits the use of the "single audit approach." We consider this proposal to be sound. Indeed, many major employers do not rely on the limited scope exemption and already use the single audit approach.

However, in order for the Department's proposal to be effective, the proposal should apply to small plans as well as to large plans. Currently, the audit requirement applies only to plans with more than 100 participants. Since most of the anecdotes that we have heard about the lack of adequate financial controls have involved small plans, the audit requirement should apply to the plans that have the greatest need for more financial supervision: plans with 100 or fewer participants.

The Labor Department has decided not to propose a "compliance audit" requirement. In view of the intricate, confusing, and often subjective rules that govern employee benefit plans, we think that a required compliance audit is neither necessary nor feasible.

The Basic Issues. Finally, before the Subcommittee takes any action on the Department's proposals, we urge the Subcommittee to carefully consider a number of basic issues. In our judgment, the Subcommittee should not act on the Department's proposals until it has considered and resolved the following issues:

1. Is there persuasive evidence of widespread mismanagement or abuse in private-sector employee benefit plans?

2. Is there persuasive evidence that private-sector employee benefit plans face an imminent financial crisis?

3. In the absence of any persuasive evidence of widespread abuse or an imminent financial crisis, is it appropriate to impose major new obligations on employee benefit plans?

4. Has the Department identified any specific areas of abuse so that any new enforcement initiatives could be applied selectively where they are needed?

5. Is there reason to believe that the Labor Department and the Internal Revenue Service could discharge their current enforcement responsibilities more effectively and efficiently?

6. Have the Department of Labor and the Internal Revenue Service been given the resources that they need to discharge their duties adequately?

7. If there is no widespread abuse and no imminent crisis, and if the responsible administrative agencies can do a better job of discharging their responsibilities, why doesn't it make sense for the Congress to focus initially on improving the performance of the agencies?

8. If the agencies have been slow to issue regulatory guidance and have not discharged their enforcement responsibilities as effectively as possible, does it make sense to require employers in the private sector to compensate for the agencies' shortcomings by absorbing the costs of increased litigation?

9. If the courts already have the authority to award attorneys' fees and costs, why is it inappropriate to continue to allow the courts to exercise their discretion based on the facts and circumstances of each individual case?

10. Is there reason to believe that the federal courts are prepared to handle a major new wave of private litigation?

11. Will the costs of increased private litigation increase or decrease the willingness of an employer to provide employee benefits?

Thank you very much. I will be happy to respond to any questions that the Chairman and the other members of the Subcommittee might have.

Mr. **Anthony**. Thank you, Mr. Davis.

Mr. Salkind.

STATEMENT OF CHESTER J. SALKIND, EXECUTIVE DIRECTOR, AMERICAN SOCIETY OF PENSION ACTUARIES

Mr. **Salkind**. Thank you, sir.

My name is Chester Salkind. I am executive director of the American Society of Pension Actuaries, acronym ASPA, and we have approximately 3,000 members who provide actuarial, consulting, and administrative services to 30 percent of the qualified retirement plans in the United States.

Our members work primarily with small plans. I would like to spend most of my time today on the IRS small plan actuarial audit program and discuss briefly the IRS regulatory approach with respect to the implementation of changes in the pension laws.

By way of personal background, I spent 20 years in the Federal Government in the three agencies primarily responsible for the administration of the pension laws, that is the IRS, DOL, and PBGC.

I think I am the only survivor of the three agencies. Thus I am not an individual who sees evil in every action of the bureaucracies.

However, I have no hesitancy to state that the small plan actuarial audit program is a highly abusive program geared to collect the maximum amount of revenue and is being conducted without regard to the statute or prior IRS published guidelines.

Furthermore, the IRS has consistently withheld information, distorted information, or simply misstated the facts in connection with this program which provides strong evidence that the program is an unjustified one.

The small plan audit program is intended to raise additional revenues of $666 million in fiscal years 1990 and 1991, exclusively from the sponsors of small retirement plans.

The program was initiated in 1989, and its basic tenants were described in IRS internal memorandum to field agents dated November 29, 1989. The memorandum stated that field agents were to reject interest assumptions below 8 percent and retirement age assumptions below 65 in small defined benefit plans.

Again, this memo only became available after we brought suit under the Freedom of Information Act and the Justice Department released it to us.

It should be noted that ERISA provides that an actuarial assumption shall be selected by the enrolled actuary on the basis of past experience, and his or her best estimate of future experience.

Some perspective on the antismall business biases of this program is obtained when it is considered that the majority of large pension plans have interest assumptions below 8 percent and retirement age assumptions below 65.

Clearly small defined benefit plans have been singled out for attack because they are less able to defend themselves. Even the well-to-do professionals which the IRS is always referring to as the subject of this program, and I will add that the program involves a lot of individuals, a lot of plan sponsors who are not well-healed professionals, even such professionals lack the resources available to a large corporation in combatting the IRS. And obviously it's more difficult for them to do so.

I think that is one of the reasons for the direction or perhaps the main reason for the direction that this program has taken. It should also be noted with respect to the issue of the establishment of assumptions by the IRS that ASPA obtained an IRS document called "Lesson 5—Actuarial Update," which provides guidance to field agents.

Again, this was obtained as a result of an FOIA lawsuit. This document states the following: For purpose of the actuarial examination program, a somewhat arbitrary definition of reasonableness has been adopted. Retirement ages of 65 or more are reasonable.

The current small plan audit program retroactively changes the rules with respect to actuarial assumptions. It will undoubtedly cause severe damage to the sponsors of many small defined benefit pension plans whose enrolled actuaries had every reason to believe that their choice of interest rate and retirement age assumptions were appropriate under the law.

I will add that it will not only adversely affect the plan sponsors and their enrolled actuaries who service these plans, but it will certainly affect those who are considering adopting a plan.

The message is very clear, that if you adopt a plan, particularly a defined benefit plan, you're at risk.

While we are confident that the IRS will lose the vast bulk of cases relating to these assumptions if they are litigated, the facts of life are that many plan sponsors will concede without litigating because of the costs involved and because they are disinclined to battle the IRS.

It is grossly unfair that they should be forced to litigate to affirm the correctness of clearly reasonable positions.

In this regard, I would like to note that Senator Boschwitz has introduced a bill, S. 2583, which would mandate the IRS adherence to the actuarial audit guidelines, which will significantly constrain the IRS. It is our understanding that a comparable bill will be introduced in the House in the near future.

We urge this subcommittee to support the passage of this legislation to require the IRS to adhere to the guidelines which they are now disavowing, at least with respect to small plans, and I will add that these guidelines were published, discussed at many meetings of pension practitioners, including our own, and clearly laid out as the applicable standards. And it was very reasonable for enrolled actuaries to rely upon them.

I would like to deal at this point with the IRS contention that they are being flexible with respect to the administration of the program, and they are not imposing these assumptions except where justified.

I already noted the nature of the original memorandum, the November 29 memorandum. On January 11, 1990, we delivered a letter to Commissioner Goldberg outlining the basic nature of this memorandum, although we did not fully have it at the time.

We only obtained the memorandum pursuant to our lawsuit on February 7.

On January 19, after our letter to the Commissioner, the IRS wrote a memorandum to its field agents ostensibly providing some flexibility in this program by allowing deviation from the prescribed assumptions if approval is obtained for the very people who formulated the prescribed assumptions in the first place.

IRS is citing statistics indicating that in the first 500 cases, they allowed interest rates of less than 8 percent in 30 percent of the cases, and retirement age of less than 65 in 20 percent of the cases.

We asked a few questions and found out that they do not know which of these 500 cases was processed pursuant to the November 29 memo. They don't know which of these cases involved funding methods where the retirement age and interest rate would be of minor consequence.

They don't even know which of these cases involve funding deficiencies wherein the lower the interest assumption, and the earlier retirement age assumption, the greater the excise tax involved.

I think the response that they provided is typical of the manner in which IRS has provided misleading information throughout this program.

I see the warning light is on, so I will try to summarize the rest as briefly as I can.

We think it's particularly ironic to note that the assumptions, the 8 percent interest and age 65 age, are inconsistent with the experience under the Federal Government's own retirement system. The IRS has attempted to prescribe the 8-percent interest assumption by stating that this return could be obtained, by investing in Treasury securities. The Federal retirement system invests its assets in Treasury securities and has always had an interest assumption lower than 8 percent. Furthermore, statistics from the OPM demonstrate that Federal employees tend to retire fairly rapidly after becoming eligible for a pension benefit.

By age 60, well over 80 percent of the Federal employees eligible for retirement at age 55 have, in fact, retired.

I see the red light is on. I will make a few brief comments about the regulations and close my presentation.

We enumerated to the subcommittee in prior correspondence numerous concerns relative to the IRS regulatory approach, that it was inconsistent with congressional intent, it was overly complex, it was not timely.

We do not think these problems have been solved by the recently issued 401(a)(4) regulations. We have a great deal of concern with their impact, particularly with respect to small plans.

We note also that they went much further than they had to in the 401(a)(4) regulations in the sense that all that was required was an update of the comparable plan discrimination rules.

We do suggest that before they get set in concrete, this subcommittee urge the IRS not to require their incorporation in the prototype instruments, and also to advise agents not to issue any determination letters on the basis of these proposed regulations.

In closing, I would like to request that the particular issues that we have cited, the small plan actuary audit program and the regulatory approach, are quite complex. We would request that another hearing be held specifically on those issues.

Thank you very much.

[The prepared statement follows:]

THE AMERICAN SOCIETY OF PENSION ACTUARIES

PRESENTS TESTIMONY ON

THE ENFORCEMENT AND ADMINISTRATION OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

BEFORE THE SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES

JUNE 13, 1990

The American Society of Pension Actuaries (ASPA) will concentrate its testimony on a discussion of the small plan actuarial audit program currently being conducted by the IRS and the regulatory approach of the IRS with respect to the implementation of changes in the pension laws.

INTRODUCTION

The Internal Revenue Service has launched an audit program which is intended to raise additional revenues of $666 million dollars in fiscal years 1990 and 1991 exclusively from the sponsors of small retirement plans. The program was initiated in 1989 and its basic tenets were described in an IRS internal memorandum to field agents dated November 29, 1989. This memorandum stated that field agents were to reject interest assumptions below 8% and retirement age assumptions below age 65 in small defined benefit plans. (This memorandum became public only after ASPA filed a lawsuit under the Freedom of Information Act (FOIA).) Some perspective on the anti-small business bias of this program is obtained when it is considered that the majority of large pension plans have interest rate assumptions below 8% and retirement age assumptions below age 65. Clearly, small defined benefit plans have been singled out for attack because they are less able to defend themselves.

It should also be noted that ASPA obtained an IRS document entitled "Lesson 5 – Actuarial Update" which provides guidance to field agents as a result of another FOIA lawsuit. This document states the following:

> "For purposes of the actuarial examination program, a (somewhat arbitrary) definition of reasonableness has been adopted: retirement ages of 65 or more are reasonable."

The current small plan audit program retroactively changes the rules with respect to actuarial assumptions. It will undoubtedly cause severe financial damage to the sponsors of many small defined benefit pension plans whose Enrolled Actuaries had every reason to believe that their choice of interest rate and retirement age assumptions were appropriate under the law. While we are confident that the IRS will lose the vast bulk of cases relating to these assumptions if they are litigated, the facts of life are that many plans sponsors will concede without litigating because of the costs involved and because they are disinclined to battle the IRS. It is grossly unfair that they should be forced to litigate to affirm the correctness of clearly reasonable positions.

FLEXIBILITY OF THE IRS/NUMBER OF EXCEPTIONS

ASPA identified the existence and basic nature of the November 29th memorandum in a letter hand-delivered to IRS Commissioner Goldberg on January 11, 1990. (The actual document was obtained from the Justice Department on February 7, 1990.) On January 19, the IRS wrote a memorandum to its field agents ostensibly providing some flexibility in this program by allowing deviations from the prescribed assumptions if approval is obtained from the very people who formulated the prescribed assumptions in the first place.

In an attempt to show that it is not arbitrarily imposing the 8%/age 65 assumptions on small pension plans, despite the contents of the November 29, 1989 memorandum, the IRS stated that "of the first 500 cases closed, our agents allowed interest rates of less than 8% in 30% of cases and retirement ages of less than 65 in 20% of cases."

Even if these statistics were accepted at face value, they would still demonstrate that the IRS has imposed the minimum age 65 retirement assumption in 80% of the cases, and the minimum 8% interest assumption in 70% of the cases. However, the actual experience of practitioners has been that exceptions have been granted by the IRS in a much smaller percentage of cases since the issuance of the November 29 memorandum. So we asked some questions. In response to these questions, the IRS stated the following:

a. It does not know when the decisions on the appropriateness of the assumptions were made. In other words, the IRS does not know which of these cases were processed pursuant to the instructions contained in the November 29 memorandum and which were processed before that memorandum became effective.

b. It does not know which of these cases involved funding method challenges, where the interest and retirement age assumptions are likely to be of no consequence, or relatively small consequence. The IRS stated further that it does not know which of these cases involve funding deficiencies, wherein the lower the interest assumption and the earlier the retirement age assumption, the greater the excise tax assessed.

In view of the above, it is evident that the IRS is using statistics in a highly inaccurate manner.

ACTUARIAL AUDIT GUIDELINES HANDBOOK

Under applicable federal law, actuarial assumptions are to be established by an Enrolled Actuary based on the past experience and anticipated future experience of the plan. What is particularly egregious is that, not only does the IRS lack the authority to prescribe acceptable assumptions, but that the current approach is inconsistent with prior guidance, such as the IRS Actuarial Audit Guidelines Handbook issued in 1984.

The IRS is now contending that their Actuarial Audit Guidelines Handbook, issued in 1984, was not intended to apply to small plans. (See attachment.) Of course, this contention was never made during the numerous public meetings at which the Guidelines were discussed since their issuance; however, the IRS now finds it convenient to retroactively declare the Guidelines inapplicable to small plans. It should be noted that:

A. The principal Guideline tool for testing assumptions is Worksheet III. Worksheet V is a feeder to Worksheet III. Worksheet V mandates a separate line entry for each participant. The Handbook exhibit illustrating completion of Worksheet V shows two participants. It shows totals for the two.

B. At one point, (Page 7(10)5(10)-37), the Handbook gives guidance to the determination of the reasonableness of the retirement assumptions in professional corporations. It provides standards to be utilized for both small and large plans.

C. One of the first public discussions concerning the Actuarial Audit Guidelines occurred at the ASPA Annual Conference in 1984. At that time, Jim Holland, then and now with the Pension Actuarial Branch of the IRS, explained how the Guidelines worked. He illustrated one point by referring to a plan covering five participants. (A cassette recording was made of every session at the ASPA Annual Conference and a copy of the session with Mr. Holland is available if you wish one.)

It should be noted that Senator Boschwitz has introduced a bill, S. 2583, which would mandate IRS adherence to the Actuarial Audit Guidelines. It is our understanding that a comparable bill will be introduced in the House in the near future. We urge this Subcommittee to support the passage of this legislation to require the IRS to adhere to the Guidelines upon which pension practitioners legitimately relied.

TECHNICAL ADVICE MEMORANDA

The IRS has recently pointed to the Technical Advice Memoranda (TAMs) issued in 1985 and 1986 in an attempt to demonstrate that they are not applying new rules in the current audit program. It should be noted that the TAMs related to plan years in the early 1980s wherein the plans involved did not have sufficient years of experience to fall within the purview of the Guidelines. Even more significant is the fact that the prevailing interest rates in the early 1980s were the highest in the nation's history (Treasury securities were yielding approximately 12% to 15%) and that the interest rate imposed by the IRS in these cases was 8%. If the same variation from the prevailing rates in Treasury securities were allowed under the current audit program, the IRS would be precluded from challenging the interest rate assumptions in virtually all the cases in which such challenges are now being made.

ASSUMPTIONS UNDER THE FEDERAL GOVERNMENT'S OWN RETIREMENT SYSTEM

It is particularly ironic to note that the assumptions prescribed in the November 29 memorandum are inconsistent with the experience under the federal government's own retirement system. The IRS has attempted to justify the prescribed 8% interest rate assumption by stating that this return could be obtained by investing in Treasury securities. The federal government's own retirement system invests all its assets in Treasury securities and has always had an interest assumption lower than 8%. Furthermore, statistics from the Office of Personnel Management demonstrate that federal employees tend to retire very rapidly after becoming eligible for a pension benefit. Specifically, by age 60, well over 80% of the federal employees eligible for retirement at age 55 have in fact retired.

A variety of studies demonstrate clearly that during the 1980s there has been a persistent and growing trend towards early retirement. Of course, the individuals who tend to retire earliest are those who have a pension benefit available. A rather stark illustration of the impact of this tendency on the retirement age assumption comes from the federal government's own retirement system. This system currently uses the assumptions that over one-half of the plan participants will retire immediately upon becoming eligible for an unreduced benefit and that nearly two-thirds of the participants will have retired within one year after eligibility for unreduced benefits.

In other words, while the actuaries for the federal government's own retirement system recognize the very strong tendency to take a pension benefit very quickly once it becomes available, the IRS actuaries are maintaining that private plans must utilize an age 65 retirement age assumption even though the pension benefit is available at an earlier age. It should be noted that many plans allow in-service distributions, so that an eligible individual can commence receiving retirement benefits at the plan's stated retirement age, without severing employment. The IRS is challenging the retirement age assumption even in such cases.

IRS PUBLIC RELATIONS

The IRS is attempting to give a favorable public relations "spin" to this program by identifying it with the retirement plans of accountants, lawyers, doctors, and other professionals. Indeed, many of the plans involved are those of such professionals. However, the program also affects any small business which has a retirement program whose actuarial assumptions do not conform to those arbitrarily prescribed by the IRS. Of course, professional organizations are entitled to legitimate deductions just as any other taxpayer. The IRS has simply defined as illegitimate for small plans only any deductions which derive from interest rate and retirement age assumptions not in conformance with those prescribed in the November 29 memorandum.

LACK OF CREDIBILITY OF THE IRS

1. The basic document underlying this program, the November 29, 1989, IRS memorandum to field agents, was made public only after the Department of Justice made it available to ASPA subsequent to a Freedom of Information Act (FOIA) lawsuit. In other words, the IRS attempted to conceal the contents for as long as possible.

2. On February 22, 1990, the IRS provided ASPA with a copy of the computer disk used by IRS field personnel in their audits of defined benefit pension plans. We obtained this copy through an FOIA request filed on December 21, 1989. Subsequently, we learned that a substantial portion of the disk had been deleted. The FOIA requires that any deleted information be identified and the reason for the deletion be provided, neither of which was done; so, there was a clear violation of the FOIA.

After we informed the IRS that we were aware of the deletion, the deleted material was provided on March 23, 1990. The disk originally provided contained a file called ACT-VAL.EXE. The deleted material is a file called ACT-INT.EXE, and is used by field agents to determine the rate of return realized on plan investments. It should be noted that the computer program on the deleted file generates two separate interest rates, one on the screen and another totally different figure when the report is printed. The rate on the screen is generally substantially less than the rate on the printed report. It is the latter and higher rate of return, which is disadvantageous to the taxpayer, that is used in the audits. The IRS is employing subterfuge by using the audit disk as the basis to collect taxes, penalties, and interest from the public.

On April 3, 1990, Assistant Commissioner (Employee Plans and Exempt Organizations) Robert Brauer held a press conference concerning the small plan actuarial audit program. In response to a question regarding the deletion of material from the disk, Mr. Brauer stated that the IRS did not understand that the deleted material was within the scope of ASPA's request. In its FOIA request, ASPA asked for the following:

> "The computer disk which is being utilized by Employee Plan field personnel in the auditing of defined benefit pension plans to analyze the reasonableness of the deductions."

The deleted material is part of the disk provided to field agents to determine the reasonableness of actuarial assumptions. There is no question that the deleted material was within the scope of ASPA's request.

3. In a letter dated February 28, 1990, written to Congressman LaFalce, Mr. Brauer stated that "there were over 700,000 defined benefit plans filings from plans with one to five participants in the 1986 to 1988 time frame."

After ASPA received a copy of this letter, we contacted Mr. Brauer's office to determine the basis for this figure, which appeared quite high. We were informed that the numbers were derived from an assumption that 20% of the 5500-EZ filings in 1987 represented defined benefit plans, which would mean that there were approximately 156,000 defined benefit plan EZ filings in 1987 (20% x 780,000). This 156,000 figure was then multiplied by three to compute the number of DB EZ filings over the 1986 to 1988 time frame.

We were told by Mr. Brauer's office that the 20% assumption was derived by applying the same percentage of defined benefit plan 5500 C and R filings to the EZ filings. This procedure seemed very questionable in view of the fact that the EZ filers constitute an substantially different universe than the 5500 C and R filers.

In the IRS press release issued on April 3, 1990, there appears the following statement:

> "We plan to examine approximately 18,000 plans over a three year period. During that time frame, there were over a half-million returns filed by defined benefit plans with 1-5 participants."

Thus, between February 28 and April 3, the number of filings quoted in IRS statements was reduced by 200,000 plans for the three year time frame.

On May 3, 1990, the IRS stated in response to a FOIA request that the actual IRS records show the number of EZ defined benefit plan 5500 filings for 1987 to be 44,992. This number was available to the IRS when both the 700,000 and 500,000 filing figures were utilized. Thus, the number of filings is approximately 330,000 less that the original number utilized by the IRS. Obviously, IRS was utilizing estimated numbers when the real number was available in an attempt to make it appear that only a small percentage of plans were being audited. It is rather startling to realize that the 700,000 number initially used overstated the total filings by about 100%.

4. On March 23, 1990, ASPA brought suit under the FOIA after the IRS refused to provide the background documents to the estimates that the small plan actuarial audit program will raise a total of $666 million in fiscal years 1990 and 1991. The IRS has adamantly refused to provide these documents. It is interesting to note that information obtained pursuant to FOIA requests demonstrate that there were no background documents relating to the legality or appropriateness of the November 29, 1989 memorandum and there are at least six background documents to the estimates that the small plan actuarial audit program will raise $666 million. (As indicated previously, none of these documents has been provided to ASPA.) These facts illustrate that the greatest concern of the IRS in this program is to raise revenue, and that it has little concern with the legitimacy of the means by which it is raised. We believe that the background documents to the revenue estimates will demonstrate that the IRS will have to apply the actuarial assumptions prescribed in the November 29, 1989, memorandum (minimum 8% interest rate assumption and retirement age not less than 65) in the vast majority of cases in order to meet the $666 million figure, contrary to the publicly stated position of the IRS that it will be flexible in its application of these standards.

5. The IRS has continuously cited the *Mirza* case as a basis for their current attack on the interest rate and retirement age assumptions in small defined benefit plans. It should be noted at the outset that the *Mirza* case did not address the retirement age issue at all; furthermore, it dealt with the interest rate issue solely with respect to an unusual set of facts which would not be present in the vast majority of cases subject to audit under the current program. The primary issue in *Mirza* was the funding method.

   With this as background, it is useful to examine the statement made by the IRS in its press release of April 3, 1990, concerning *Mirza*:

   > *"In the summer of 1988, the United States District Court for the Central District of Illinois decided in the Service's favor in a case called Mirza v. IRS. The Seventh Circuit Court of Appeals affirmed this decision unanimously in August 1989. The Court held that an employer must base his funding assumptions on 'experience and reasonable expectations'. Among other things, the plan in Mirza utilized a 5% assumption at a time when safe investments were yielding 12% or more. In Mirza, the Appellate Court disallowed $510,000 in deductions claimed for the one year in question (1980)."*

   One of ASPA's actuaries analyzed the total disallowance in *Mirza* ($509,971). Approximately 92% of the disallowance ($468,592) related to the funding method utilized, and only 8% of the disallowance ($41,379) related to the interest rate assumption. It should be noted that there is no indication in the IRS press release that the primary issue in the *Mirza* case was the funding method, and the reader is left with the mistaken impression that the $510,000 disallowance related primarily to the interest rate assumption.

IRS REGULATORY APPROACH

On September 26, 1989, ASPA sent a letter to this Subcommittee addressing our concerns with respect to the IRS implementation of changes in the pension laws enacted in TRA '86, OBRA '86 and '87. We provided examples in four major areas (described below) in which the IRS implementation of these changes was defective.

(1) The IRS has not met deadlines for issuing regulations established in TRA '86, OBRA '86 and OBRA '87;

(2) Procedural irregularities have occurred with respect to the manner in which the laws have been implemented;

(3) In a number of situations, the position of the IRS has been inconsistent with Congressional intent; and

(4) The regulations or notices frequently make compliance much more complex and costly than is necessary.

The IRS has recently released a package of regulations which contains proposed regulations implementing the discrimination requirements under I.R.C. Section 401(a)(4), as well as regulations under 401(a)(26), 401(a)(17), 401(k), 401(l), 401(m), 410(b), and 414(s).

In advance of the issuance of the 401(a)(4) regulations, the IRS had promised simplified regulations with broad safe harbors which would make the compliance burden relatively painless. The reality does not accord with the promise.

At the outset, it should be noted that the IRS was not required to issue any broad regulation relative to the discrimination requirements under Section 401(a)(4). The only regulatory guidance that was necessary was a substitution for Revenue Ruling 81-202, which related to the determination of discrimination in comparable plans (two or more plans that are treated as a single plan). Rather than limit its efforts to issuing the regulations required under Section 1141 of TRA '86 by February 1, 1988, the IRS has proposed discrimination regulations applicable to all plans which imposes a radically new approach. The fundamental thrust of the 401(a)(4) regulations is that discrimination with respect to defined benefit plans is determined on an annual accrual basis, rather than on the projected benefits basis which has been the approach utilized for decades.
Insofar as the promise of simplicity with respect to the 401(a)(4) regulations, it should be noted that, as sent to the Federal Register, they comprised 188 pages. Suffice it to say at this point that they are as complicated as they are long. It should be noted that even the safe harbors rely upon certain facts and circumstances determinations.

Contrary to the assertion of the IRS concerning the ability of most plans to come within the purview of the safe harbors, it is our judgment that these safe harbors are quite narrow. If a plan does not fall within these safe harbors, it is required to comply with the general discrimination rule. Under this rule, a plan cannot determine whether it has complied until after the plan year is over. A violation results in immediate taxability to all highly compensated employees of the value of vested benefits.

We believe the proposed 401(a)(4) regulations will create significant problems for both large and small plan sponsors. It will be particularly devastating to the small defined benefit plan universe for two reasons:

1. The approach that the IRS has adopted severely restricts the ability of a plan to provide past service credit. Since, in most cases, a small employer is not financially able to establish a pension plan until the business has been in operation for a number of years, this limitation precludes the small employer from providing adequate pension benefits to those long-serving employees who were responsible for the development of the business.

2. Since the addition, change in status, or departure of a few employees, or even a single employee during the plan year can significantly impact on whether or not a plan conforms to the general rule, the fact that a determination cannot be made until the plan year is over is particularly troublesome to small employers who may have difficulty utilizing restructuring. This is so because the use of restructuring involves demonstrating that each of several sub-plans satisfies a coverage test. The addition, change in status, or departure of one or a few employees can have a profound effect on the satisfaction of a coverage test in a small plan.

The proposed 401(a)(4) regulations state that, generally, they will not be effective until 1991; however, we are very concerned that this regulation will be implemented before there has been an adequate opportunity to review the propriety and impact of this radically new approach to discrimination testing. Consequently, we request that this Subcommittee urge the IRS to adopt the following positions with respect to the 401(a)(4) regulations to prevent damage resulting from immediate implementation:

1. No List of Required Modifications (LRMs) to the prototype documents will be issued based on the proposed 401(a)(4) regulations.

2. IRS personnel will ignore the proposed 401(a)(4) regulations in their review of determination letters.

NEED FOR FUTURE HEARINGS

We recognize that this particular hearing is broad sweeping in nature. Naturally, there is a limited ability in such a hearing to adequately focus on the particular problems we have described. We therefore urge that an additional hearing(s) be held in the very near future specifically relating to the audit program and the IRS regulatory approach to the implementation of the pension laws. We believe that both of these problems are causing substantial damage to the private pension system, and that such a hearing is necessary to resolve them before additional and irreparable damage is done.

As to (8), this Actuarial Guidelines Handbook (Guidelines) through written content or otherwise infers the following: These guidelines are in effect only "guidelines" and techniques to be used by Employee Plans (EP) Specialists. It is intended to assist EP Specialists in examining Defined Benefit Pension Plans.

If a pattern of substantial gains is observed, the deductible limit may be too high. This infers that substantial gains resulting basically from the use of a low interest rate assumption may but does not necessarily mean that deductible limits are too high.

The Guidelines are not appropriate for small plans. They are geared toward larger plans where there are existing factors such as mergers, acquisitions, plan liability transfers, existing experience (employee turnover, deaths, disability, salary increases, benefit changes, i.e. as in union/non-union collective bargaining agreement, etc.)

Actuarial assumptions and the reasonableness thereof is very subjective. The Guidelines suggest that if may be necessary for the EP Specialist to discuss with the National Office Actuarial Branch findings made as a result of completing the various worksheets within the Actuarial Guidelines Handbook and in particular as regarding Worksheet III.

> It is not reasonable that an actuary, an expert in his/her field, would rely on general audit guidelines to be used by Employee Plans Specialists to determine reasonable actuarial assumptions. It is difficult to believe that an actuary, in this case or any other case, would contact the Internal Revenue Service National Office Actuarial Branch in order to discuss the findings that they made in conjunction with the completion of "Worksheet III" relative to the soundness of actuarial assumptions.

As to the taxpayer's argument on Retirement Age, all aspects of the taxpayer argument have been adequately addressed in the Government's Position (see page 7.)

Conclusion:

Accordingly, since the determination of the deductible limits for the respective plan years was based on the results of an actuarial deduction using assumptions that are unreasonable, no reliance can be placed on the deductible limits so determined. The deductible limits have been recalculated on the basis of reasonable actuarial assumptions (assumed Normal Retirement Age of 65, pre-retirement interest rate of 8%, post-retirement interest rate of the greater of (a) 8% using a Straight Life Benefit Annuity form, or (b) 8% using a Joint and 100% Survivor Benefit Annuity form. The corrected deductible limits (amounts) are as follows:

8512 - $16,798
8612 - $18,240
8712 - $14,972

Mr. ANTHONY. Thank you, Mr. Salkind.

Mr. Lauer, I believe you're our final witness.

STATEMENT OF AUGUST LAUER, SENIOR MANAGER, EMPLOYEE BENEFITS, FEDERAL EXPRESS CORP., ON BEHALF OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS (APPWP), ACCOMPANIED BY JAMES A. KLEIN, DEPUTY EXECUTIVE DIRECTOR, APPWP

Mr. LAUER. Good afternoon. I would like to thank you for the opportunity to testify before the subcommittee on behalf of the APPWP, whose members either directly sponsor or administer employee benefit plans covering more than 100 million Americans.

I would also like to thank Representatives Anthony and Chandler for their support of pension simplification.

Accompanying me is Jim Klein, deputy executive director for the APPWP, who will also be pleased to answer any questions the subcommittee members may have.

The written statement submitted for the record describes the APPWP's analysis of the Department of Labor proposal and ERISA enforcement and auditing procedures.

The main point I would like to emphasize to the subcommittee as it considers the enforcement and auditing proposals is to carefully weigh the benefit of any changes with the stepped up enforcement and associated additional cost which would be imposed on the system.

Specifically, with regard to the elimination of limited scope audits and contemplated ERISA compliance audits, Congress must consider whether there are sufficient resources within the accounting industry to fulfill that role and the ability of plan sponsors to pay for it.

With regard to the proposal for mandatory attorney's fees, Congress must consider whether that will invite litigation of limited merit. Further, we would ask Members of Congress to question what evidence exists which would indicate that the current practice of judicial discretion on the award of fees does not meet the objective of permitting participants with valid claims to seek the appropriate legal remedy.

As indicated on this chart, the defined benefit plans were in decline in 1989. There was a 37-percent increase in plan terminations and 67-percent decline in new plan formations.

These numbers indicate that employers are finding it too costly, too cumbersome, and too onerous to either continue sponsoring retirement plans or to even form new plans.

Mr. LAUER. Federal Express, however, is committed to its retirement plan.

We provide one plan to all 70,000 of our part-time and full-time employees.

Supporting these plans is a staff of inhouse professionals along with third-party consultants, attorneys and actuaries.

The concern of the APPWP and Federal Express is that there are other firms with fewer resources which are becoming disenchanted with the pension system because of the complicated and expensive cost of administration.

Clearly, one thing that would enhance the administration of the pension system would be simpler laws. The APPWP does not just want to complain about burdens in the system but rather offer suggestions for how to achieve some simplification.

The APPWP gridlock report lists 27 specific recommendations for simplification. We do not have time to go through them all. However, a few bear noting.

A 15-percent excise tax is imposed on individuals for excess distribution. This excise tax was originally intended to replace the complex combined plan limitations of section 415 with a simpler and more equitable scheme for limiting retirement income.

However, as finally enacted, the excise tax does not replace the combined plan limitations, but is applied in addition to them.

This duplicative set of regulations should be eliminated. The minimum participation rules were designed to prevent discrimination in favor of the highest paid employee or owner-employees.

Its original focus was comparatively narrow. However, the regulation has grown a life of its own and now appears so broad that nearly all plans will be affected by it.

We believe Congress should eliminate this legislation or specifically target its application as originally intended.

As regards 401(k) plans, TRA86 drastically limited the amount of contribution to these plans in two ways. First, it reduced the individual contribution limit from $30,000 to $7,000 per year.

Second, it further tightened the average referral percentage test referred to as the ADP permitted under the law. The ADP test was originally designed to ensure that the participation of highly compensated employees, those employees earning greater than $50,000 per year indexed, was within a certain percentage of nonhighly compensated employees, those employees who would be earning less than $50,000.

The regulations further provide that in the event the plan does not satisfy the test at plan year end, the employer must take certain actions to guarantee compliance.

This requires in most cases the actual return of contributions to the highly paid employees after the end of the plan year.

Over 30,000 of Federal Express employees participate in our 401(k) plan. Since the passage of the restricted ADP test, we have continuously found ourselves potentially not in compliance with the test.

Rather than continue until the end of the plan year, which on a fiscal basis ends May 31, at which time we would be forced to return money to the highly compensated employees, we have opted to reduce the contribution for these employees during the plan year in the hopes we would meet the test by the end of the plan year.

Because of the manner in which the limitation of contributions must be applied, we are forced to reduce the contribution percentage of our highly compensated employees starting at the top limit, which is 10 percent of pay, and bring it on down until all highly compensated employees are at or below a certain level.

For example, the past plan year required that highly compensated employees cold not contribute on the average more than 4 percent of pay. Quite obviously, the higher paid employees were able to contribute more dollars than the marginally higher paid employees or those employees earning just over $50,000.

Additionally, those employees not considered highly paid were able to contribute up to the plan limit of 10 percent of pay. This created in many of our employees a situation of extreme inequity.

The arbitrary limit of $50,000 for the definition of highly compensated created a situation where an employee, by the very nature of working overtime, may have broken the $50,000 threshold and thereby was limited in his contribution, while an employee who may not have worked the overtime and not broken the $50,000 threshold was able to contribute up to the plan maximum.

We believe this is unfair and arbitrary, particularly given our pay for performance compensation program.

Additionally, the complicated regulations require in our case that we make the best guess as to what it would take to comply with the test in midyear and take appropriate action at that time.

This on-again, off-again contribution for our marginally highly compensated employees is at best confusing and unsettling as the compensation fluctuates from year to year.

I would submit that the Federal Government recognize this equity versus complexity issue when it obtained an exemption from the ADP test in the savings plan for Federal employees.

In any event, the current ADP test should be eliminated. The $7,000 maximum limit has produced the intended result, which was to limit the amount of money super highly paid employees can contribute to these plans versus nonhighly compensated employees.

The continuation of the existing ADP test and its associated complex administration will only serve to discourage employers from offering 401(k) plans.

On behalf of the APPWP and Federal Express, I would like to thank the committee for the opportunity to express our views.

[The prepared statement follows:]

Statement of

August Lauer
Senior Manager of Employee Benefits
Federal Express

on behalf of the

Association of Private Pension and Welfare Plans

on

Enforcement and Administration of the Employee Retirement Income Security Act of 1974

before the

Subcommittee on Oversight of the Committee on Ways & Means

June 13, 1990

Mr. Chairman and members of the Subcommittee, I am August Lauer, Senior Manager of Employee Benefits for Federal Express. I am pleased to appear today on behalf of the Association of Private Pension and Welfare Plans (APPWP). The APPWP is a national trade association dedicated to the voluntary private sector employee benefits system. Our members include employer sponsors of benefit plans and firms which provide services to those plans. Together, our members either sponsor directly or provide services to plans covering more than 100 million Americans.

We applaud you, Mr. Chairman, for holding these hearings to investigate the enforcement and administration of the Employee Retirement Income Security Act of 1974 (ERISA) which is so vital to millions of Americans. The timing of this hearing is especially critical given the imminent release of the legislative language of the Department of Labor's (DOL) proposals concerning ERISA enforcement and auditing procedures.

The APPWP would like to take this opportunity to critique and offer our suggestions regarding the DOL proposals. In addition, we would like to offer some positive recommendations that the APPWP believes could improve the administration of the pension system and the enforcement of the laws and regulations governing it.

Clearly, simplifying a number of aspects of pension law would assist the effort to achieve better administration of benefit plans. Importantly, also we believe these simplification proposals, if enacted, could help expand the nation's private pension system so that its benefits could be enjoyed by more workers and retirees. We are encouraged that Chairman Dan Rostenkowski has indicated that simplification of the Internal Revenue Code will be a priority for him and the Ways & Means Committee this year. We hope that much-needed improvements in the pension area will be included in the Chairman's recommendations. We are also heartened that Representative Rod Chandler and Senator David Pryor have decided to introduce, along with their colleagues, major pension simplification legislation.

Before discussing our specific points regarding ERISA enforcement and pension simplification, an overview of the pension system is in order.

A MAGNIFICENT PENSION SYSTEM IN PERIL

The nation's pension system is a paradox. On one hand, it is a model of success thanks, in great measure, to tax incentives that Congress has wisely encouraged over many decades. On the other hand, the very survival of that system is threatened as never before. First, the good news.

Today, some 45 million Americans are covered by the private pension system and employers account for roughly 87 percent of the contributions to retirement plans. According to the U.S. Department of Labor Statistics, the private pension system has grown from $17 billion in assets in 1950 to $1.7 trillion today.

Moreover, the private pension system stands out as perhaps the only bright light in an otherwise dismal record of national savings. In 1986, pension and profit-sharing plan contributions accounted for roughly 51 percent of new savings. According to a study submitted by David Wise to the National Bureau of Economic Research, employees would have to save an average of 3 to 7 percent of their wages to make up for what employers put aside for them.

The best news, however, is that the private retirement system is one of the best bargains for retirees and for the Federal Treasury. Although the Federal revenue expenditure for private pensions is estimated at $47.4 billion in Fiscal Year 1990, the benefits paid to retirees by employer plans in 1988 (the most recent year for which data is available from the National Income Accounts of the U.S. Commerce Department) is approximately $200 billion. Benefits paid are 4.6 times the foregone Federal tax collected! And of course pension contributions are not tax excluded but, rather, tax deferred until benefits are paid.

While the good news is very good, the bad news is very bad. For those fortunate enough to participate in the system, employer plans are generous and fair. But employers -- in truly alarming numbers -- are finding that it has become too costly, too cumbersome and too onerous to continue sponsoring retirement plans.

Data reported by the Internal Revenue Service for 1989 tells the story in graphic terms. Last year there were three times as many terminations of defined benefit pension plans -- plans which are the bedrock of the American pension system -- as there were new plan creations. That is even worse than in 1976 when the full impact of the Employee Retirement Income Security Act (ERISA) was felt and terminations doubled new plan establishments. (See Appendix A)

Regrettably, we can not even take comfort in the belief that the bad news last year was due solely to provisions of the 1986 Tax Reform Act (TRA) which required the termination of many plans in 1989. The really alarming news last year was that while terminations of existing plans rose by 37 percent, new plan creations plunged by 67 percent. Many American businesses -- especially small and mid-sized firms -- are dissatisfied with the system and are cancelling plans. And newer companies are concerned with the confusion, cost and complexity of the system and they are avoiding the formation of new plans which are essential if we are to provide tomorrow's retirees with more than just a Social Security check to meet their income security needs.

THE CAUSES OF PENSION GRIDLOCK

What has caused all this complexity? Several factors. In great measure it has been the unrelenting legislation and regulation in the pension arena. Congress has significantly revised the rules governing the benefits system in 1980, 1981, 1982, 1984, twice in 1985, twice in 1986, 1987, 1988 and 1989.

Since 1986 alone, several hundred typewritten pages of proposed employee benefits regulations have been published by the Treasury Department. And that is the good news. What has really frustrated employers and employee benefits professionals is that the regulatory agencies have not completed the issuance of regulations. For most employee benefits provisions of the 1986 Tax Reform Act, the Treasury Department was given until February 1, 1988 to issue final regulations so that plan changes could be made in 1989. Many of these regulations are not even yet published in proposed form. The largest component of these regulations --over 300 pages-- were only published in proposed form a few weeks ago.

What has caused this flood of legislation and regulation? Unquestionably, a desire to raise revenue is partially to blame. Fully 15 percent of the $280 billion in tax increases levied by the Tax Reform Act came from pension and other benefits changes. For too long pension law has been governed by revenue considerations, rather than retirement policy. But that is not the whole answer. Revenue alone does not explain why one third of the TRA's volume involved employee benefits provisions.

The reason for complexity, we believe, lies also to a great extent in two erroneous beliefs held by many lawmakers and regulators. The first is something we call "evil plan myopia". In short, it is the myopic view of many policymakers who believe that employers are intent upon cheating their employees out of a fair share of benefits and, therefore, the rules governing plans must take into account every theoretical kind of alleged abuse imaginable. Instead of focusing on actual abusive situations, form is elevated above substance. The result is that the vast majority of employers are compelled to comply with complicated rules that have little bearing on their practices.

An adjunct to "evil plan myopia" is the increasing tendency to target tax expenditures to certain groups of employees through complex non-dsicrimination rules. The most egregious example of this was Internal Revenue Code Section 89. However, while Section 89 is gone, other examples of this attempt to target benefits by shifting to employers the burden of proving non-discrimination, still exists.

The second erroneous belief is what we call "computer omnipotence". This is the equally unrealistic assumption that once employers are directed to make certain changes to their plans, or to apply certain tests, all the employer needs to do is press a button and magically compliance will be possible. Computer omnipotence totally overlooks the reality of corporate recordkeeping.

Companies typically have different payroll systems -- especially where there are separate lines of business or facilities in different geographic areas. Much of the compliance requires obtaining information from employees and former employees who are often reluctant to disclose this information. Even where accurate compliance is possible, the expense of engaging lawyers, accountants, actuaries and consultants -- to say nothing of inside personnel -- to cope with continually changing laws and regulations is driving employers away from their traditional support for the pension system.

More than a decade of legislation, delayed and voluminous regulations, a thirst for revenue from the private employee benefits system, "evil plan myopia" and "computer omnipotence" have all combined to cause total pension gridlock.

ERISA ENFORCEMENT AND AUDITING PROCEDURE PROPOSALS

Against this background of the nation's pension system--both its strength and its tremendous complexity--we would like to turn our attention to the specific enforcement and auditing proposals recommended by the Administration. The APPWP is second to no one in our steadfast support of logical, understandable and fair policies on enforcement of the laws governing the pension system. Where the Department of Labor, its Inspector General or the Congress have uncovered evidence of inadequate auditing procedures or enforcement mechanisms, we support improvements.

We also wish to commend Assistant Secretary David Ball and the DOL for the very open process by which they developed their recommendations for enforcement and auditing changes and their receptiveness to public comment on various concerns that were raised. At the same time, however, we are ever aware of the extent to which the pension system has been burdened by needless regulation and costly requirements and we counsel the Subcommittee to scrutinize carefully the potential impact and relative cost-effectiveness of additional requirements imposed on the sponsors of employee benefit plans. Our comments are based upon the proposals outlined by DOL in its March 20, 1990 letter to Rep. Tom Lantos describing forthcoming legislation.

Limited Scope Audits

The DOL proposes that the limited scope audit exception under ERISA be eliminated. This proposal certainly has merit, but important precautions must be taken to ensure that the limited scope audit exception is replaced by something workable. While the APPWP can agree that plan assets held by financial institutions ought to be subjected to independent audits, it would be enormously onerous to require a financial institution's auditor to render an opinion on the financial condition of the assets of each of the hundreds or thousands of plans maintained by the institution.

We believe that the financial institution's audit should focus on the adequacy of internal accounting controls on an overall basis and not on a plan-by-plan basis; which would extraordinarily increase the cost of audits to sponsors of benefit plans. The burden of such an approach on the pension system can not be overstated.

In addition, the DOL proposal suggests that once a plan's auditor has received the financial institution's audit, the plan's auditor will be able to express an unqualified opinion with respect to the plan. This is not necessarily true. Currently, most plan auditors simply express no opinion with respect to assets held by a financial institution. The goal ought to be to allow plan auditors to express an opinion, but not mandate that the opinion be unqualified.

ERISA Compliance Audits

The DOL has indicated that it will recommend that plan auditors conduct an ERISA compliance audit (or other appropriate audit) in addition to the financial audit now undertaken by auditors. This recommendation could be very far-reaching and difficult to implement. ERISA compliance involves such matters as diversification, prohibited transactions, prudence, bonding, appeals procedures, vesting, plan participation and a number of other fiduciary and tax issues which it seems unreasonable to expect an accountant to fully address. Given the current complexity of the law governing benefits plans, it would be difficult, if not impossible, for the person performing the audit to know what standards to apply. Not surprisingly, the accounting profession, itself, has resisted the proposal to require auditors to perform these additional functions.

To even begin to properly perform an ERISA compliance audit will require many more professionals than just the plan's financial auditor. The cost of those additional professionals will significantly increase the costs and burdens of plan compliance. This proposal exemplifies the "evil plan myopia" that we cited earlier. If there is a particular problem that is identified and demonstrated as serious, then proposals to solve that problem should be developed. However, a broad-based proposal that would subject all benefit plans to massive and costly review is clearly overkill. Even if a compliance audit were substantively feasible, it is highly questionable whether as a matter of cost-effectiveness it is worthwhile given the substantial extra burdens it would impose upon accountants and sponsors of benefit plans.

Mandatory Attorney and Expert Witness Fees

The APPWP supports the right and ability of plan participants to seek redress of legitimate grievances. The award of reasonable attorney and expert witness fees in appropriate cases can aid in this effort. The APPWP believes that the current practice of permissive award of these fees furthers that purpose without unduly inviting unmeritorious lawsuits. The DOL proposal to make mandatory the award of attorney and expert witness fees to prevailing plaintiffs in fiduciary breach cases is overreaching.

Often fiduciary breach claims are asserted in ordinary benefit claims cases. It would certainly not seem to further the purpose of the DOL's proposal to require the award of fees when a participant prevailed in a routine benefit claims dispute where the denial of benefits was made in good faith. The current judicial discretion for the award of fees guarantees against such an unjust result, while permitting the award of fees and costs where the claimant has asserted a serious fiduciary breach or where the plan sponsor acted in bad faith.

There are many unanswered questions regarding mandatory fee awards including: its applicability to routine benefit claims cases, the use of plan assets for insurance premiums to cover the costs of defending against claims, the impact on fiduciary insurance costs, and whether the proposal would also permit successful defendants to charge the plan for the cost of their defense. These factors must be considered and satisfactorily resolved before Congress can make changes in the law that would foster more litigation.

Monetary Incentives to Report Violations/Sect. 4975 Penalty Increase

The APPWP has concerns about the so-called "bounty" proposal that allows the Secretary of Labor to award a portion of the penalty under ERISA Section 502(l) to individuals providing the DOL with information leading to the institution of a case; and the proposed increase in the Internal Revenue Code Section 4975 excise penalty tax. We believe that any changes made to either penalty need to be coordinated with one another so that the result is not a duplicative nor inequitable outcome.
The APPWP is concerned that the bounty proposal could be expanded to include all cases -- not just suits brought by the Department of Labor -- including benefit claims cases. Congress must be especially vigilant to ensure against such expansion. If extended to private lawsuits, the bounty will certainly be an invitation to groundless assertions and unwarranted litigation.

If the Section 4975 penalty is increased, any additional amount should be paid to the plan in question -- not to the government or individual plaintiffs. The purpose of any penalty increase should be to deter unacceptable behavior, not to raise revenue for the government. Therefore, the focus should be on protecting the interests of participants, rather than enriching the government.

De Novo Review of Benefits Cases Where a Conflict of Interest Exists

Another DOL proposal would provide for de novo judicial review of benefit claims disputes where there exists a direct financial conflict of interest between the claimant and the plan administrator contesting the claim. This proposal could transform virtually every benefits dispute into full-scale litigation and allow plan participants to avoid plan dispute resolution procedures which work expeditiously and economically. The concept of what is a "direct conflict" under the DOL proposal is vague. There is always a conflict when a plan administrator works for and is paid by a plan sponsor. The proposal does not adequately recognize that plan administrators are fiduciariesand must act in accordance with ERISA's fiduciary duties in making benefit determinations.

If the goal of this proposal is to require that all plans must hire independent fiduciaries to make benefit claims determinations, that objective should be made clear. Based on the evidence before us, the APPWP could not support such a proposal since it is questionable whether that would be even economically feasible for most plans.

Registration of MEWAs

The APPWP supports DOL's proposal to require registration of MEWAs in order to assist state insurance departments in policing these arrangements. MEWAs hold great promise for expanding benefit coverage among small businesses. At the same time, there has been considerable concern about the practices of certain MEWAs. MEWA registration seems to be an example where the additional administrative cost is sensible and cost-effective and should not unduly burden the system.

Proxy Voting

The Department of Labor proposes to require persons with proxy voting power to disclose to participants and beneficiaries, upon request, the plan's proxy's voting record.

We believe that there are valid public policy interests in keeping proxy voting confidential. For example, with respect to self-directed plans and ESOPs, disclosure of such information could subject participants to certain harassment because of their voting record.

Moreover, even if these policy objections could be overcome, absent a careful crafting of any related requirements, the administrative problems of complying with proxy voting requests could be enormous. At a minimum, such proxy voting information should only be be required to be made available in summary form and not until some reasonable period of time after the end of the proxy season. In addition, it should be available for review in the offices of the plan sponsor and the sponsor should be able to charge participants and beneficiaries a reasonable amount to defray the cost of providing and/or copying the information requested.

IMPROVING THE ADMINISTRATION OF THE PENSION SYSTEM

We would like to turn now to the issue of pension simplification, because the current complexity of the pension system is inextricably linked to its administration by sponsors of plans.

The APPWP does not wish to dwell simply on the complexity of the private retirement system. We want to tell you what can be done to achieve some measure of simplification. The APPWP's Retirement Savings Committee and its Board of Directors spent nearly a year developing a list of legislative changes that Congress could enact to erase much of the complexity that is due to duplicative, obsolete or simply unnecessary rules. Our report: "Gridlock: Pension Law in Crisis and The Road to Simplification" published in September 1989 contains 29 specific recommendations that, if adopted, would make the system simpler and more rational.

We are heartened that since the publication of "Gridlock" other organizations have endorsed the recommendations made in our report. Likewise, we are gratified that many on Capitol Hill and in the Administration have recognized that simplification of the Internal Revenue Code is a worthwhile goal.

It is not possible to describe today all 29 recommendations we have made. A copy of our "Gridlock" report has been sent to all members of the Senate Finance and House of Representatives Ways and Means committees. I would just like to take this opportunity to list a few examples of egregious complexities in the pension system in need of simplification:

A. Excise Tax on Excess Distributions

A provision enacted by TRA, Section 4980A, imposes a 15 percent excise tax on individuals to the extent that annual aggregate distributions from tax-favored arrangements exceed the greater of $150,000 or $112,500, indexed.

This excise tax originally was intended during TRA to replace the complex combined plans limitations of section 415(e) with a simpler and more equitable scheme for limiting retirement income. However, as finally enacted, the excise tax does not replace the combined plans limitations but is applied in addition to them, and it is neither simple nor equitable. We believe, therefore, that tax should be eliminated.

B. Minimum Participation Rules

The minimum participation rule, Section 401(a)(26), was designed to prohibit discrimination in favor of highly compensated employees and employees with significant ownership interest in the employer. Its original focus was comparatively narrow: it was aimed at the elimination of individual defined benefit plans -- plans which covered only the highest paid employee of the employer. However, the provision has grown a life of its own, and now appears so broad that nearly all plans will be affected by it, and so complex that compliance necessitates review of a large number of pages of regulations and expenditure of excessive amounts of time and money.

We are pleased that the previous set of proposed 401(a)(26) regulations have been withdrawn and replaced by much improved rules. Nonetheless, Congress still needs to reconsider the policy underlying the statute and we would continue to urge the legislative elimination of the provision or its more targetted application to individual defined benefit plans.

C. 401(k) Average Deferral Percentage (ADP) Tests

As we all know, the contribution limits for 401(k) plans, the most popular savings vehicle ever in a savings starved nation, were severely reduced by TRA from $30,000 to $7,000. But the TRA, in the name of greater equity, also further tightened the average deferral percentage test ("ADP") permitted under the law. The ADP test was originally designed to assure participation by nonhighly compensated employees (i.e. those who earn less than about $50,000 per year) by limiting 401(k) deferrals by highly compensated employees to a ratio based on deferrals by the lower paid.

The rules for calculating, returning and taxing deferrals in excess of the ADP limits are extremely complicated. In addition, the ADP tests include a multiple use test which make 401(k) contributions subject to still other test limitations under section 401(m), rules on lineal descendants, separate testing for ESOP portions of the plan, and an "adjusted balance" provision for determining income on excess amounts, all of which are examples of unnecessary complexity that far outweigh any possible utility.

While the ADP test may have made sense when the maximum 401(k) deferral was $30,000, its impact on senior management under the reduced limitation is negligible. Because of the interaction with the maximum limitation (once again, originally $7,000) on 401(k) deferrals, the ADP test only serves to penalize the lower end of the highly compensated group. In a typical situation, if an employee earning $50,000 contributes $7,000 to a 401(k) plan, the individual's deferral percentage will be 14 percent. If the firm president contributes $7,000 and earns $200,000 that person's deferral percentage is 3.5 percent. If the ADP tests are not met, the $50,000 employee's deferral must be reduced first, because of that person's higher deferral ratio, even though that individual's contribution was the same as the president's.

To assure compliance with the ADP tests, many plan sponsors enact rules limiting the amount that the highly-compensated can defer, unfairly penalizing the lower end of the highly compensated group to the advantage of the most highly paid employees. For example, if a company places a 3.5 percent ceiling on contributions by the highly compensated, a president earning $200,000 could defer $7,000, but an employee earning $50,000 could defer only $1,750. Another employee earning $49,000 could defer the full $7,000 simply because he or she is not deemed to be "highly compensated." Because of results like these, the incentives associated with having senior management's level of contribution dependent on the contributions of lower paid individuals is dissipated.

It further frustrates private employers that the federal government -- recognizing that the degree of equity obtained versus the complexity introduced by these reduced limited was out of balance -- sought and obtained an exemption to the ADP tests in its own savings plan.

In sum, while the rules may have made some sense when the deferred limits applied to 401(k) plans were $30,000, they don't make much sense when the maximum limit is around $7,000. Given their complexity and the anomalous situation that many highly paid executives can put more money into 401(k) plans than lower paid executives, the additional costs associated with the tests are not warranted by any corresponding increase in equity. This test is unfair, inequitable and discourages employers from offering 401(k) savings plans to employees. These "ADP" rules must be eliminated.

D. Paperwork Burdens

The burdens of the various reporting and disclosure requirements that ERISA and the Internal Revenue Code impose upon retirement plans cannot be overstated. While many such requirements are valuable, and almost all are well-intentioned, many of these requirements are costly and serve to confuse plan participants. Employers are deluged with paperwork requirements which include Annual Reports, Summary Annual Reports, Summary Plan Descriptions, Summary of Material Modifications, IRS forms 5300, 5301, 5302 and so on, PBGC Form 1, etc. Following 1987 tax and accounting changes, employers who previously could meet ERISA requirements by paying an actuary to do a single valuation, must do at least four valuations.

Much of this required paperwork is duplicative and unnecessary. The Summary Annual Report, which is distributed for all ERISA plans to employees, is a good example. Employers are required to use a format dictated by the Department of Labor which is intended to insure uniformity and clarity. This requirement needs to be eliminated.

Reporting requirements, should be reviewed so that they only require disclosure of information that is truly useful to either participants or the government. The APPWP urges that any changes in required reports or forms only be made if the changes are substantial and made at one time. Typically, it costs more to reprogram computers, retrain employees and set up new filing systems than is saved by just minor changes.

E. Rational Effective Dates

As I described above, many employers and others who provide services to retirement plans find that compliance with the law is made infinitely more difficult by the enormous delay of the regulatory agencies in issuing regulations. Sometimes the delay is caused by the regulators' overly-complex evaluation of Congressional intent. Other times, Congress, itself, has not given clear guidance or has simply legislated so much that those who write the implementing rules are overwhelmed.

In either case, employers should not have to squander resources simply because regulations are issued years late. Retirees should not suffer because employers are forced to freeze benefit accruals due to a lack of guidance from the government.

We propose that, henceforth, Congress make clear whenever it is adopting new benefits legislation, that the effective date of the changes made be delayed until some reasonable period (perhaps eleven months as envisioned in TRA) after the issuance of final regulations. This period should give plan sponsors an adequate period of time to make any necessary plan changes and communicate those changes to plan participants. Congress must also step-up its oversight of the regulatory agencies to ensure that they meet the deadlines set for them by law.

PENSION SIMPLIFICATION IS COST-EFFECTIVE

We are mindful that two charges may be made by some against an effort to achieve major simplification. The first, is that simplification, itself, may cause additional administrative expense if it necessitates plan or operational changes. Of course we oppose change for the sake of change. When the APPWP developed "Gridlock" we considered and rejected a number of changes that, while furthering simplification, might have caused additional administrative changes that were not worth the level of simplification achieved. The APPWP has taken great care to ensure that the enactment of the changes meet the test of common sense practicality. These are changes that real corporate benefits managers will find helpful and worthwhile.

Most of our recommendations involve specific elimination or modification of unnecessary, obsolete or duplicative rules -- or at least giving plan sponsors options from which to choose. Hence, Congressional enactment of these recommendations will for the most part not necessitate additional regulations nor plan or operational changes by benefits managers.

The APPWP strongly believes that those who may contend that adopting simplification recommendations will somehow cause more complexity and expense because employers would then have to comply with new -- albeit simpler -- rules, are applying the same kind of tortured reasoning that regulators sometimes use in justifying pages and pages of regulations on the basis of a few simple lines of statutory language. Benefit managers who are on the front lines of administering plans are the ones who developed these recommendations. Even where additional plan or operational changes might be necessary, they believe that the overall resulting simplification and long-term cost savings will be well worth the immediate changes made.

The second concern that may be raised regarding pension simplification, is that some important changes may result in lost federal revenues. In the current budget deficit climate, it is vital to squarely address this matter. It is ironic that so much pension complexity has been championed over the years in the name of achieving equity -- while the sponsors of pension plans have long suspected that raising revenue was often the real culprit. Now that virtually everyone acknowledges that the pension system is a complex mess, revenue loss is mentioned as an obstacle to making changes that are essential to simplifying the system so that its benefits can more equitably be enjoyed by more Americans.

In calling for pension simplification, the APPWP is not urging new revenue expenditures. Congress has already wisely concluded that certain revenue expenditures are appropriate to encourage the growth of the private sector pension system. What we do urge is that the system be allowed to work. Overly complex and technical rules that constrain the growth of the system and that require employers to waste money on needless plan administration -- rather than on benefits -- should be corrected or eliminated.

At the same time, we urge the Congress to keep in mind not just the cost of the private pension system -- but its value as well. We discussed above the enormously positive cost/benefit ratio of the pension system in terms of tax revenues deferred in exchange for benefits paid. Congress must consider how much more expensive it would be for taxpayers to directly subsidize -- either through increased Social Security benefits or other programs -- the same level of retirement benefits now provided by private pensions.

CONCLUSION

The administration of the nation's private benefit system and the laws and regulations that govern is vital. While improvements clearly can be made, special care must be taken to ensure that well-intentioned proposals not impose greater burdens on an already overburdened system. At the same time, Congress has an excellent opportunity to ease compliance burdens for sponsors of pension plans and ensure more accurate adherence to pension laws by enacting a number of much-needed simplification proposals. The APPWP urges the favorable consideration of these changes.

We appreciate this opportunity to testify and would be pleased to offer our continued assistance to the Subcommittee as it further considers these important matters.

Chairman **Pickle**. Well, I want to thank you, Mr. Lauer, and I want to thank all of the panelists.

This completes the hearing for today. I would like to ask anyone of the witnesses now at the table if you have any additional statements you want to make, other than the testimony that you have given. All of your statements will be made a part of the record.

Do any of you wish to make any additional statements?

It's been a long hearing, and I don't want to prolong it. I notice that during all the hearing today, Mr. Ugoretz, you haven't had anything to say, and I will be glad to hear from you.

Mr. Davis spoke, but you usually have something to say to us. Would you like to comment further?

Mr. **Ugoretz**. Mr. Chairman, I thank you for this invitation, but this has been a long day, and I will decline at this time.

Chairman **Pickle**. Thank you, Mr. Ugoretz.

I am mindful that some of you are concerned about the approach we are taking to the C.P.A.'s. We will explore the possibility of some kind of a group discussing these problems, and I appreciate your cooperation. I am glad we have had this hearing. Some of you have insisted we have a hearing on this very subject and came to see us over and over, and now we have the hearing, and now you want more hearings. And I imagine if we have more hearings, you will still want more hearings. I am glad to see, though, that most of you here testified that any changes in regulations ought to apply to small plans instead of just large plans. There is a combination that we have got to make in these fields and a lot of these things are not in our jurisdiction as a committee. We recognize that.

And I notice you, Mr. Davis, didn't want a possible increase in the excise tax. But we are holding the hearing to get information, and each one of your positions is well taken, and we respect you for it, and we will be talking with other committees with jurisdiction to see what we can do. Of course, we will also make a report from the subcommittee to the full committee.

In general, let me ask you, do you agree or disagree with the proposal made by the Labor Department with respect to some of these changes?

In general, are they the right approach? Does anybody have any, other than just instead of just picking at it, Mr. Lauer?

Mr. **Klein**. I am Mr. Klein. I am accompanying Mr. Lauer.

I think it's a mixed bag. I think that as the testimony indicates, certainly some of the changes, for example, the limitation of the limited scope audit, is appropriate, and we can support that.

The only thing that we would counsel the committee to consider is what would then replace that elimination of the limited scope audit. If it's going to require separate audits of each plan for which a particular financial institution serves as trustee, that is obviously going overboard.

Chairman **Pickle**. I understand.

Mr. **Klein**. But those kinds of considerations.

Mr. **Davis**. Mr. Chairman, we would support that the Department of Labor and the Internal Revenue Service should be given adequate resources to enforce ERISA. We would disagree with the idea that the Department of Labor is turning its burden on private attorneys and increasing civil litigation.

Chairman Pickle. That is not surprising.

Mr. Davis. In all honesty, we don't think private, civil litigation is the way to resolve problems. We have seen it not work very effectively.

Chairman Pickle. Why do you think the Department of Labor recommended that?

Mr. Davis. Well, I think to some extent that the don't—maybe they are hesitant to increase their staff. Maybe they are limited by costs. Maybe they want to privatize the enforcement and avoid their responsibility.

Chairman Pickle. Well, we have a lot of questions. We recognize that in one case a man cannot get any information about his plan. He even hired an attorney. Eventually, however, if it comes out favorably, if he could get that reimbursement, then that would encourage perhaps thousands of others to do the same thing. And that is what you are concerned about, I presume.

I am not prepared to say what course to take. I just recognize it as a serious problem, and I assume that the Department of Labor is just trying to find some justice in some of this litigation.

Mr. Ugoretz. Mr. Chairman, I am not familiar with the case in detail, but assuming that he had a good case, he already has the opportunity to receive attorney and witness fees at the discretion of the court. That is in current law.

Our concern is that the idea of mandating these attorneys and witness fees will generate increased litigation that is really not necessary.

Chairman Pickle. I am not arguing that particular case or the merits of that case because I am not that familiar with it.

But it's a point of concern to the Department of Labor, obviously, or they wouldn't have made that kind of recommend.

Mr. Walker.

Mr. Walker. Mr. Chairman, one of the issues that was not addressed by the Labor Department's recommendations, which I think merits further exploration, is certain reporting and disclosure issues. One of the things that I know you, Mr. Chairman, have a personal interest in is underfunded plans, and that presumably the Government would have an interest as well as plan participants and beneficiaries as to the funding statutes of their plans since the funding statutes of their plan can be indicative of the potential risk to benefit security.

I would submit that the current reporting and disclosure mechanisms, whether it be the form 5500, the semiannual report, or other documentation, are wholly inadequate with regard to properly disclosing the funding status of plans. And that is something that I think might be reviewed.

We will look into that aspect of it. It's true that I have been very concerned over the years with the underfunded plans; 2 and 4 years ago, we worked on this, some of the plans were in alarmingly dangers condition.

Now that we have taken positive steps to ensure that these plans are more fully funded, I think we are in much better shape financially than we have been.

Now, I admit that in the process, some of the smaller plans might have been pushed out or been by decision forced to cancel, or they decided it wasn't worth the hassle.

So I accept that there has been some hardship in that area, but when you look at the overall good or bad on it, I think that 5 percent of what we have done is good, or whatever percentage you want to take.

Now, while I am concerned about underfunding, let me say, also, that I think we have got to be concerned about the overfunded plans in order to be sure that we have got equity in it.

But here again, we are not trying to pass judgment on any one aspect of the overall program. But we do recognize that while we have made changes in recent years, we ought to stop just tinkering with it all the time.

The changes we have made have been very important for the solvency of our overall program for the funds. I think we are in much better shape than we were 3 or 4 or 5 years ago, and I think if we can find a better way to look at further some of these things, I think we can settle down on some routine, but normal, operations. That is what we strive to achieve.

So I want to thank you for your cooperation today, and I appreciate—yes, sir.

Mr. KLEIN. If I might, I just want to echo a point that Mr. Walker just referenced when we talked about the fact that a number of reporting requirements are woefully inadequate for the purpose of the enforcement mechanism that the agencies are trying to achieve. And I just want to say there is a perfect opportunity in this report "Gridlock," that Mr. Lauer referenced, that calls for a number of simplifications.

We call for a number of simplifications in the report—specifically in the area of reporting and disclosure, and so there is really a unique opportunity here to achieve, in changing some of these reporting and disclosure requirements, both better enforcement through more appropriate information, as well as simplified administration for the sponsors of plans.

Mr. HOFFMAN. Mr. Chairman, just one comment.

You had mentioned tinkering, and you thought the law shouldn't be tinkered with. And I agree with you, and that particularly applies to that penalty that is floating there, to move it from 5 to 10 percent. It's just another one of the moves that isn't going to be of substantial significance, and I think you should let it alone and let enforcement take place and apply the penalties that presently exist.

Chairman PICKLE. That is something of specific concern to this committee. I appreciate your statement.

Well, again, I want to thank you. You have been with us all day, and it's been a long, drawnout sort of a hearing, but I think we have had some excellent statements and information for the record.

So I thank you all. The committee then will stand adjourned.

[Whereupon, at 3:10 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

In the United States House of Representatives
Committee on Ways and Means
Subcommittee on Oversight

Comments on the Enforcement and Administration of the Employment Income Security Act of 1974

Submitted by: John C. Brooks
North Carolina Commissioner of Labor

Date: June 28, 1990

I address this committee as Commissioner of Labor for the State of North Carolina and as a member and officer of the National Association of Governmental Labor Officials (NAGLO) to express a widely-held concern among state labor officials over the lack of effective assistance available from the Pension and Welfare Benefits Administration (PWBA) and the United States Department of Labor to working citizens of our states who have complaints arising under the Employment Retirement Income Security Act of 1974 (ERISA) for nonpayment of promised severance pay. Through these comments, I will outline the evolution and extent of the problem and share the solution proposed by NAGLO.

On July 23, 1986, the United States Supreme Court affirmed without opinion the decisions of the Second and Fourth Circuit Courts of Appeal holding that ERISA preempts North Carolina's and New York's wage collection laws as they apply to the enforcement of an employer's promise to give severance pay to its employees.[1] Shortly after these decisions, the Director of the North Carolina Wage and Hour Division contacted the Atlanta Area Administrator for the Pension and Welfare Benefits Administration to determine the appropriate manner in which to make referrals to that office of employees' complaints of failure to receive promised severance pay. We were advised by the Area Administrator that due to the overwhelming caseload of his office and its limited number of investigators (a total of 10 for the eight states in his region), we were to advise severance pay complainants to send a letter of written complaint to the Pension and Welfare Benefits Administration's Division of Technical Assistance and Information in Washington, DC.

We have complied with these instructions, but we are greatly distressed by the limited amount of assistance given to our referrants. Several referrants have reported to us that the only assistance which they have received from the PWBA has been in the form of a letter explaining to them the manner in which they might pursue their claims on their own. If these reports are indicative of the actual "assistance" being given to all or the majority of severance pay complainants, then these complainants are receiving what amounts to no assistance at all. This is especially true when the present "assistance" is compared to the significant help these complainants had been receiving from the departments of labor in North Carolina and other states prior to the Supreme Court's decisions. It is difficult for us to believe that this lessening of protection for employees was intended by Congress when ERISA was adopted.

According to a survey made by the Interstate Labor Standards Association in 1985, at least thirty-three states have statutes obligating employers to pay promised wages and wage-like benefits such as severance pay, vacation pay, sick pay, and holiday pay.[2] Twenty-eight of these statutes specifically include severance pay within their provisions. All of these states offer administrative assistance to employees who complain of their employer's failure to pay promised severance pay. North Carolina has a staff of 27, including 16 investigators, to assist with these complaints. A few states have staffs which exceed 100, including California, whose staff exceeds 400. In addition to investigative and administrative assistance, at least 20 of these states are empowered by their statutes to file criminal or civil action on behalf of the employees to recover unpaid promised severance pay. The widespread assistance offered by the states, however, was abruptly cut off with the Supreme Court decisions of 1986. Now, since the amount of assistance offered by the PWBA under ERISA is so negligible, the states desire to resurrect their authority to give assistance.

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[1] See Brooks v. Burlington Industries, Inc. 477 U.S. 901 (1986), sum. aff'ing, Holland v. Burlington Industries, Inc. 772 F.2d 1140 (4th Cir. 1986), and Roberts v. Burlington Industries, Inc. 477 U.S. 901 (1986), sum. aff'ing, Gilbert v. Burlington Industries, Inc. 765 F.2d 320 (2d Cir. 1985).

[2] A copy of the survey is attached as Exhibit 1.

Twice NAGLO has adopted resolutions proposing that Congress enact an amendment to ERISA which returns to the states the authority to enforce employers' promises to pay severance pay to their employees.[3] The most direct method by which Congress could accomplish this issue would simply be to make an exception to ERISA's preemption provisions for state laws enforcing promised welfare benefits. There are already several exceptions to ERISA's preemption for other kinds of state laws, and it would be technically simple to add an additional one.

A second way in which Congress could achieve this goal is suggested by the primary issue raised by North Carolina and New York in their appeals to the Supreme Court in the Burlington Industry cases: what constitutes a "plan" covered by ERISA? It would appear from the face of ERISA as well as a reading of its legislative history that Congress intended to regulate and enforce pension and welfare benefits plans which are entities in and of themselves and which have identities separate and apart from the employer or employee groups creating them. Thus, it would appear that while Congress intended to regulate separate welfare or pension plans, it never intended to usurp the states' rights to regulate and enforce direct promises by employers to their employees to pay wages and benefits out of their general operating funds and assets. That intention, however, was not expressed explicitly enough in ERISA to convince the Supreme Court. Congress could now amend ERISA to make explicit its intention to exclude direct employer promises to pay unfunded benefits from ERISA's coverage. This solution has the appeal of clearly separating an area of federal regulation from an area of traditional state regulation along a logical and easily defined line.

I respectfully request this subcommittee to study the need to clarify ERISA on the subject of preemption of state wage payment laws and to propose for adoption by Congress the amendment suggested by the National Association of Governmental Labor Officials. If I or my staff can be of any assistance in your consideration of this matter, please do not hesitate to contact me.

Respectfully submitted,

John C. Brooks

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[3] Copies of the resolutions are attached hereto as Exhibits 2 and 3. These resolutions proposed amending ERISA to exclude from its preemption state laws obligating employers to pay not only promised severance pay but also other employee welfare benefits such as vacation pay, sick pay and holiday pay. Following the adoption of these resolutions, however, the Supreme Court held in *Commonwealth of Massachusetts v. Morash* __ U.S. __, 109 S.Ct. 1668, 104 L.Ed.2d 98 (1989), that ERISA does not preempt benefits such as vacation pay, sick pay and holiday pay which are essentially "payroll practices" as defined in regulations adopted by the Secretary of Labor. Thus, the resolutions are no longer relevant in their reference to vacation pay, sick pay, and holiday pay, but are submitted in relation to severance pay only. It is our experience that severance pay plans often resemble the payroll practices which the Court found to excluded from ERISA coverage. Payroll practices are defined in the Secretary's regulations as practices which continue the payment of the employee's normal wages during periods of absence from work and which are paid for out of the general assets of the employer rather than out of a special fund set up for that purpose. The severance pay practices reviewed by the Court in the 1986 Burlington Industries cases also provided for the continuation of the employee's normal wages and were paid for out of the employer's general assets rather than a special fund.

Exhibit 1

ERISA COMMITTEE REPORT
to the
Twenty-First Annual ILSA Convention
Tuesday, August 5, 1985

Chairperson:	Thomas A. Harris, North Carolina
Members:	Joseph C. Armer, New York
	Nance S. Milberger, California
	Donald McGrath, Michigan

In 1974 Congress adopted the Employee Retirement Income Security Act (ERISA) to regulate the creation and administration of employee benefit plans by employers. In addition to regulating retirement benefits such as pension plans, ERISA also applies to "employee welfare benefit plans." These latter benefit plans are defined as including employer plans or funds to provide vacation pay, sick pay, holdiay, and severance pay, among other benefits. Congress also included a provision that ERISA supersedes "any and all state laws insofar as they relate to any employee benefit plan."

At the 1984 ILSA meeting in Little Rock, several states reported that employers were challenging the application of their state wage collection laws to certain fringe benefits on the grounds that ERISA preempts those state laws as they relate to fringe benefits regulated by ERISA. In response to those reports, this committee was appointed and charged to perform the following functions: to act as a clearinghouse for information relating to ERISA preemption challenges to ILSA members' wage collect statutes; to facilitate a united approach to defending those challenges in court; and to assist in the National Association of Governmental Labor Officials (NAGLO) in seeking a Congressional amendment to ERISA to clarify that wage collection laws are not preempted as they apply to vacation pay, severance pay and similar "employee welfare benefits."

In performance of its first function, the committee sent a questionnaire to each ILSA member jurisdiction (all fifty (50) states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands). Of the fifty-four (54) surveys sent, thirty-eight (38) were completed and returned (thirty-seven (37) states and the District of Columbia). Partial information was available from four (4) other states. A chart summarizing the information collected from these forty-two (42) jurisdictions is attached to this report. Of those forty-two (42) jurisdictions, thirty-three (33) have wage collection statutes which provide for the enforcement of one or more of the same fringe benefits ostensibly regulated by ERISA as an "employee welfare benefit plan." All but one of the jurisdictions which have such statutes provide administrative assistance to employees who complain that they have not been paid the benefits they were promised. Collectively, these jurisdicitons have 1,105 staff members giving this assistance. Criminal charges may be brought against employers failing to pay promised benefits in twenty-two (22) jurisdictions. A civil lawsuit to recover the benefits is permissible under the wage collection statutes of thirty-one (31) jurisdictions, by the employee only in seven (7) jurisdictions and by either the employee or the government on behalf of the employee in twenty-four (24). In addition to the benefits owed, an employer can recover interest in nineteen (19) jurisdictions, extra damages in twenty-two (22), and an attorney's fee in nineteen (19). The administrative finding of the enforcing government agency is enforceable against the employer in court in fourteen (14) jurisdictions. These statistics show what is at stake in the resolution of the ERISA preemption issue. Should ERISA ultimately be applied so as to supersede all state wage collection statutes, vast resources for enforcing promised employment benefits will be lost to employees throughout the nation.

Ten (10) states report having had their wage collection statutes challenged as preempted by ERISA, either in administrative proceedings or in state or federal court. Wyoming reports that since the first of 1985 employers have been consistently raising ERISA preemption in Administrative proceedings to enforce promised vacation pay. Wyoming is holding these cases in abeyance pending the forthcoming decision of the United States Court of Appeals for the Ninth Circuit with respect to preemption of California's statute. In Michigan, the office of administrative hearings first held the Michigan statute to be preempted, then later held that it was lacking in authority to decide the preemption issue since it raised a constitutional question. Thus, Michigan is still able to enforce its statute administratively. In North Carolina, one employer raised preemption during the investigation of a vacation and severance pay claim, but consented to pay because it believed the benefits to be due under ERISA in any event. New York has had a similar experience. In state court, both Iowa (small claims court), and Maine (superior court) have obtained favorable decisions in the face of ERISA preemption challenges to the application of their state wage collection laws to vacation and severance pay. Thus, it appears that state courts may provide a friendly forum for states defending their statutes.

On the other hand, with one exception, federal courts have dealt the most devastating blows to state laws using the ERISA preemption club. California has been enjoined by separate federal district courts from enforcing its wage collection statute as it applies to vacation pay and severance pay, respectively. The vacation pay decision was appealed to the Ninth Circuit Court of Appeals, where briefs and oral arguments have been submitted and a decision is being awaited. New York has had its wage collection state as applied to severance pay held to be preempted both by a federal district court and, on appeal, by the Second Circuit Court of Appeals. North Carolina's statute met a similar fate in federal district court, though the appeal to the Fourth Circuit is still pending. Illinois has had the lone success in federal court, obtaining a district court ruling upholding its statute as applied to vacation pay. That decision, however, is on appeal to the Seventh Circuit Court of Appeals. Earlier, another district court had held that ERISA preempted Illinois' wage collection statute where employees sought to use the state law to enforce an employer's obligation to make contributions to an employee benefit fund. Maine is currently facing a challenge in federal district court to its wage law as applied to vacation and severance pay. A decision is expected within the next few months.

Substantial efforts have been made by several states to assist other states facing the ERISA preemption issue. New York and North Carolina filed a friend of the court ("amicus curiae") brief in support of California in its defense of its statute as applied to vacation pay in the Ninth Circuit. The United States Department of Labor also filed an amicus brief in support of California. Alaska, Connecticut, Hawaii, Illinois, Maryland, Montana, Oklahoma, Vermont, Wisconsin, and the District of Columbia joined North Carolina in filing an amicus brief in support of New York in the Second Circuit. The same states joined New York in support of North Carolina in the Fourth Circuit. These briefs are available from the committee chairperson on an "as needed" basis as the briefs are voluminous. Help is also available from the committee to coordinate amicus brief assistance to other states who may be defending ERISA challenges at the appellate court level. A special request for assistance will be made to all states with wage collection statutes applying to benefits if a preemption case reaches the United States Supreme Court.

An analysis of the court decisions and the rationales underlying them indicates that the most difficult case to defend is a preemption attack against a state statute applied to severance pay. In the long run, defense of state enforcement of this benefit may be a lost cause. On the other hand, application of state wage collection laws to vacation pay, sick pay and holiday pay, when such benefits are paid for out of an employers general assets rather than a special fund set aside for that purpose, stands an excellent chance of being upheld in the long run. This circumstance is due in a large part to a United States Department of Labor regulation which interprets ERISA not to apply to "payroll practices" which provide normal wages from an employer's general assets for periods when an employee is absent from work for reasons such as vacations, illness, and holidays. However, a California federal district court has held this regulation to be improper interpretation of ERISA.

Thus, the ultimate form of relief from the ERISA preemption problem may have to come from Congress. At its July, 1984, meeting NAGLO adopted a resolution supporting an amendment to ERISA to clarify that it does not preempt state wage collection laws. A copy of that resolution is attached to this report. Subsequently, each NAGLO member has been encouraged to contact its congressional delegation to gather support for such an amendment. Several states have already made such contacts, with some promising results. Indication has been given by the House Subcommittee on Labor-Management Relations, which oversees ERISA, that it will study the preemption question during this Congress, probably after the first of next year. More directly to the point, Representative Roy Dyson of Maryland has indicated an interest in introducing a bill similar to the NAGLO proposal. His staff is currently working on a draft of such a bill.

It would be extremely valuable for each ILSA member to encourage the NAGLO member from his or her state to contact the state's congressional delegation now, if it has not already been done. It would be particularly helpful to make contact with the members of the House and Senate sub-committees which oversee ERISA. A list of those subcommittees and their members are attached to this report.

As there are further developments on an ERISA amendment, this committee will share pertinent information at appropriate times. Those states with representatives or senators in the committees to which such a bill would be referred will have a more important role to play in the initial stages of the adoption process.

This report is sure to have missed some developments in the area of ERISA preemption. ILSA members are encouraged to send additional information and news of new developments to the committee chairperson. Any questions about this report or requests for information or assistance are also welcome.

Subcommittee on Labor
of the Committee on Labor and Education
United States Senate

Majority Members (Republicans):

Don Nichols, Oklahoma, Chairman
Orrin G. Hatch, Utah
Robert T. Stafford, Vermont
Malcolm Wallop, Wyoming

Minority Members (Democrats):

Howard M. Metzenbaum, Ohio
Edward M. Kennedy, Massachusetts
Spark M. Matsunaga, Hawaii

Subcommittee on Labor-Management Relations
of the Committee on Education and Labor
United States House of Representatives

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William D. Ford, Michigan
Dale E. Kildee, Michigan
Mario Biaggi, New York
Charles A. Hayes, Illinois
Mervyn M. Dymally, California
Chester G. Atkins, Massachusetts
Major R. Owens, New York
Augustus F. Hawkins, California (Ex Officio)

Minority Members (Republicans):

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Rod Chandler, Washington
Richard K. Armey, Texas
Steve Bartlett, Texas
Harris A. Fawell, Ilinois
James M. Jeffords, Vermont (Ex Officio)

State	Has Statute:		Covers:					State Gives Admin. Assistance	Total Staff	Criminal Violation	Civil Suit	- by employee	- by state	In Court Can Recover:					Binding Administrative Decision	Had ERISA Challenge	Won/Lost	Type of Benefit
	Discrimination	Wage Payment	Sick Pay	Holiday Pay	Vacation Pay	Severance Pay	Other							Benefits	Interest	Extra Damages	Attorney's fee	Other				
Alabama	No	No																				
Alaska		Yes			X	X		X	16		X	X	X	X								
Arizona	No	Yes	X	X	X	X	X1	X	7	X	X	X		X	X2	X	X		X			
Arkansas	Yes	No						X	3	X	X	X		X	X							
California	Yes	Yes	X	X	X	X		X	425	X	X	X		X	X		X		X	X	2L	sev. vac.
Colorado	No	Yes			X			X	9	X	X	X	X	X		X26	X			X		
Connecticutt	No	Yes	X	X	X	X		X	14	X	X	X	X	X		X3	X					
Delaware																						
Dist of Columbia	Yes	Yes	X	X	X	X	X1	X	6	X	X	X	X	X		X3	X					
Florida	No	No																				
Georgia																						
Guam																						
Hawaii	Yes	Yes	X	X	X	X		X	9		X	X	X	X		X3	X	X4				
Idaho	No	No																				
Illinois		Yes	X	X	X	X	X15	X	14	X	X	X	X	X	X10					X	W	vac.
Indiana	Yes	Yes5			X			X	3		X	X	X	X		X6	X		X			
Iowa	Yes	Yes	X	X	X	X	X7	X	8	X	X	X	X	X	X	X8	X			X	W	vac.
Kansas	Yes	Yes	X	X	X	X	X9	X	17	X	X	X		X	X	X10		X11	X	X		
Kentucky	Yes	Yes	X	X	X	X	X12	X	31	X	X	X	X	X	X	X	X		X			

State	Has Statute:		Covers:					State Gives Admin. Assistance	Total Staff	Criminal Violation	Civil Suit	- by employee	- by state	In Court Can Recover:					Binding Administrative Decision	Had ERISA Challenge	Won/Lost	Type of Benefit
	Discrimination	Wage Payment	Sick Pay	Holiday Pay	Vacation Pay	Severance Pay	Other							Benefits	Interest	Extra Damages	Attorney's fee	Other				
Louisiana																						
Maine	Yes	Yes			X	X		X	9		X	X	X	X	X	X3	X			X	W	sev. vac.
Maryland	Yes	Yes	X	X	X	X	X1	X	12	X	X	X	X	X		X2						
Massachusetts	No	Yes		X	X			X	55		X	X		X	X							
Michigan	Yes	Yes	X	X	X			X	48	X	X	X	X	X	X	X13	X		X	X	W	vac.
Minnesota																						
Mississippi	No	No																				
Missouri	No	No																				
Montana		Yes21			X	X		X			X	X	X	X		X23	X		X			
Nebraska	Yes	Yes	X	X	X	X	X9	X	7		X	X	X	X			X	X14				
Nevada																						
New Hampshire	Yes	Yes	X	X	X	X	X24	X	13		X	X	X	X		X25	X		X			
New Jersey	Yes	Yes	X	X	X	X	X15	X	105	X	X	X	X	X	X	X			X			
New Mexico	No	Yes	X	X	X	X		X	11	X	X	X	X	X	X	X16			X			
New York	No	Yes	X	X	X	X	X1	X	155	X	X	X	X	X	X	X17	X		X	X	L	sev.
North Carolina	No	Yes	X	X	X	X	X1	X	25		X	X	X	X		X3	X			X	L	sev.
North Dakota																						
Ohio	No	No																				
Oklahoma		Yes	X	X	X	X	X15	X		X												

State	Has Statute:		Covers:					State Gives Admin. Assistance	Total Staff	Criminal Violation	Civil Suit	- by employee	- by state	In Court Can Recover:					Binding Administrative Decision	Had ERISA Challenge	Won/Lost	Type of Benefit
	Discrimination	Wage Payment	Sick Pay	Holiday Pay	Vacation Pay	Severance Pay	Other							Benefits	Interest	Extra Damages	Attorney's fee	Other				
Oregon	Yes	Yes	X	X	X	X	X15	X	10	X	X	X	X	X	X	X			X			
Pennsylvania	Yes	Yes	X	X	X	X		X	31	X	X	X	X	X	X	X8	X			X	W	pen.
Puerto Rico																						
Rhode Island																						
South Carolina	No	Yes	X	X	X	X	X1	X	13	X	X	X		X		X18						
South Dakota	No	No																				
Tennessee	No	No																				
Texas	No	Yes			X	X		X	31		X	X		X	X		X	X19				
Utah	Yes	Yes20			X20	X		X	5													
Vermont	No	Yes	X	X	X	X		X	3	X	X	X		X								
Virginia	Yes	Yes21	X	X	X					X	X	X	X	X								
Virgin Islands																						
Washington																						
West Virginia																						
Wisconsin	Yes	Yes	X	X	X	X	X15	X	5	X	X	X	X	X		X22			X			
Wyoming	Yes	Yes	X	X	X	X	X15	X	16		X	X	X	X	X		X		X	X		

NOTES

1. All other amounts promised by the employer
2. Treble damages
3. Double damages
4. Bank handling fee (bounced check)
5. State Appelate Court Decision establishes right to sue for vacation pay under wage collection statute
6. 10% per day, not to exceed double the amount owed
7. Health Benefits
8. Liquidated damages
9. Any fringe benefit promised by the employer when the employee meets conditions for eligibility
10. 1% per day, up to 100% of unpaid wages
11. Personal liability of corporate officer or agent for wages owed by corporation if violation knowingly permitted
12. Any similar advantage agreed upon by the employer and the employee or provided to the employees as an established practice
13. Civil Penalty and exemplary damages
14. Civil Penalty in amount equal to unpaid wages, distributed to state school system
15. Any other agreed upon benefit
16. Up to 60 days additional wages
17. Liquidated damages to 25%
18. Continuation of wages
19. Civil Penalty
20. Requires vacations for minors in covered industries
21. Interpretation of statute by State Attorney General authorizes its application to fringe benefits
22. Up to 50% of unpaid wages or $500.00, which every is greater
23. 5% of unpaid wages per work day up to 100% of unpaid wages
24. Expenses, personal pay, bonuses, commissions
25. 10% of unpaid wages for each day except Sunday and legal holidays upon which failure to pay continues up to an amount equal to the unpaid wages
26. 50% penalty

Exhibit 2

NAGLO RESOLUTION

ERISA AMENDMENT

Submitted by John C. Brooks
Commissioner of Labor, State of North Carolina

WHEREAS, the majority of states have laws requiring and enforcing the payment of wages promised by employers; and

WHEREAS, the majority of state wage payment laws apply to wages in the form of one or more of the following employee benefits, to wit, vacation holiday pay, sick pay, severance pay or other similar benefits promised by employers; and

WHEREAS, the United States Congress has enacted the Employee Retirement Income Security Act of 1974 (ERISA) which regulates, among other things, employee welfare benefit plans; and

WHEREAS, an employee welfare benefit is defined in ERISA as including many of the same benefits covered by state wage payment laws, to wit, vacation pay, holiday pay, sick pay, severance pay and other similar benefits; and

WHEREAS, ERISA by its own terms supersedes "any and all state laws insofar as they may now or hereafter relate to any employee benefit plan;" and

WHEREAS, the United States Supreme Court has held in the case of Shaw v. Delta Airlines, Inc., _____ U. S. _____, 103 S. CT. 2890 (1983) that "Congress used the words 'relate to' . . . in their broadest sense" and that a law "relates to" an employee benefit plan "if it has a connection with or reference to such a plan;" and

WHEREAS, the United States District Court for the Central District of California has held in the case of California Hospital Association v. Henning, 569 F. Sup. 1544 (C.D. Calif. 1983) California's wage payment law "relates to" employee vacation benefits within the meaning of ERISA and, thus, is superseded by ERISA and is unenforceable; and

WHEREAS, a growing number of employers in various states throughout the nation are challenging through court and administrative proceedings the viability of state wage payment laws in light of ERISA's preemption provision, making it increasingly difficult for state labor law administrators to enforce their states' wage payment laws; and

WHEREAS, pending resolution of the preemption issue by the Supreme Court, administration of state wage payment laws will be greatly hindered, resulting in a substantial reduction in states' abilities to enforce the payment of wages promised to employees; and

WHEREAS, the present controversy over preemption of state wage payment laws by ERISA has resulted and will continue to result in a lessening of protection for employees which was neither intended nor envisioned by Congress; and

WHEREAS, preemption of state wage payment laws by ERISA takes away from the states an area of regulation traditionally reserved to the states and, thus, upsets the traditional balance between state and federal enforcemnt of wages; and

WHEREAS, states are uniquely qualified and able vis-a-vis the federal government to enforce wage payments and, thus protect their working citizens;

NOW THEREFORE BE IT RESOLVED BY THE NATIONAL ASSOCIATION OF GOVERNMENTAL LABOR OFFICIALS IN ITS 67TH ANNUAL CONVENTION ASSEMBLED IN TULSA, OKLAHOMA DURING THE WEEK OF JULY 8, 1984,

That the Association does hereby request and recommend to the United States Congress that it adopt the Amendment, set out below, to the Employee Retirement Income Security Act:

"An Act to amend and clarify ERISA by adding a second and thrid sentence to section 514(a), 29 U.S.C. §1144(a):

State laws prohibiting employers from discriminating in the provision of employee benefits, obligating employers to pay promised employee welfare benefits to its employees and providing for the enforcement of such obligations shall not be considered laws relating to an employee benefit plan. The foregoing sentence shall not apply to employee pension benefit plans."

Be it further resolved that a copy of this amendment be sent to the President, the Secretary of Labor, and to all members of Congress at their convening in 1985.

NAGLO RESOLUTION

ERISA AMENDMENT
Unanimously Adopted July 31, 1986 in Bismarck, N. D.
Submitted by John C. Brooks
Commissioner of Labor, State of North Carolina

WHEREAS, the majority of states have laws requiring and enforcing the payment of wages promised by employers in the form of vacation pay, holiday pay, sick pay, severance pay or other similar benefits; and

WHEREAS, the United States Congress has enacted the Employee Retirement Income Security Act of 1974 (ERISA) which regulates, among other things, employee welfare benefit plans; and

WHEREAS, an employee welfare benefit plan is defined in ERISA as covering many of the same benefits covered by state wage payment laws, to wit, vacation pay, holiday pay, sick pay, severance pay and other similar benefits; and

WHEREAS, ERISA by its own terms supersedes "any and all state laws insofar as they may now or hereafter relate to any employee benefit plan;" and

WHEREAS, on June 23, 1986, the United States Supreme Court affirmed the decisions of the Second and Fourth Circuit Courts of Appeals that ERISA preempts state wage collection statutes as applied to promised severance pay and, furthermore, declined to resolve the unsettled question of law whether ERISA preempts those statues as applied to other payroll benefits including vacation, holiday and sick pay;

WHEREAS, pending resolution of the preemption issue by the Supreme Court, administration of state wage payment laws will be greatly hindered by expensive and time consuming court challenges to their statutes; and

WHEREAS, the Supreme Court's ruling of partial preemption as to severance pay and the continuing controversy over broader preemption of state wage payment laws by ERISA has resulted and will continue to result in a lessening of protection for employees which was neither intended or envisioned by Congress; and

WHEREAS, preemption of state wage payment laws by ERISA takes away from the states an area of regulation traditionally reserved to the states and, thus, upsets the traditional balance between state and federal enforcement of wages; and

WHEREAS, states are uniquely qualified and able vis-a-vis the federal government to enforce wage payments and, thus protect their working citizens;

NOW THEREFORE BE IT RESOLVED BY THE NATIONAL ASSOCIATION OF GOVERNMENTAL LABOR OFFICIALS IN ITS 69TH ANNUAL CONVENTION ASSEMBLED IN BISMARCK, NORTH DAKOTA DURING THE WEEK OF JULY 27, 1986:

That the Association does hereby request and recommend to the United States Congress that it adopt an amendment to the Employee Retirement Income Security Act of 1974 which excludes from preemption by that Act state laws obligating employers to pay promised employee welfare benefits and providing for the enforcement of such benefits including, but not limited to, severance pay, vacation pay, sick pay and holiday pay.

Be it further resolved that a copy of this resolution be sent to the President, the Secretary of Labor, and to all members of Congress at their convening in 1987.

TESTIMONY OF

THE NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

The National Telephone Cooperative Association (NTCA) is a national trade association representing almost 500 small, independent cooperative and commercial telephone systems serving rural customers in more than 42 states. On the average, our member systems provide telephone service to areas with an overall density of less than 5 customers per mile of telephone line. Half of our members are commercial companies and half are cooperatives.

We commend the Chairman and the members of the Subcommittee on Oversight for having a hearing on the enforcement and administration of the Employee Retirement Income Security Act of 1974 (ERISA).

The National Telephone Cooperative Association has attempted to ensure that pension and welfare benefits are available to employees of small telephone systems in rural areas who might otherwise not have access to these benefits. NTCA also offers benefit plans to the members of the association and their families. NTCA's employee retirement and savings plan is among the top 600 in the country.

We feel that ERISA should be amended to protect bona fide welfare benefit programs maintained by trade associations, for their members, from multiple and conflicting state law.

Many national or regional trade associations sponsor welfare benefit programs to provide medical, disability and death benefits to employees of those association members who choose to participate. Through these programs, trade association members, many of which are small employers, are able to provide their employees with better benefits at a more reasonable cost than if such employers arranged for such benefits through an insurance company. Where the participating employers are in the same industry and certain other requirements are met, the tax laws allow such programs to be established as tax-exempt "voluntary employee beneficiary associations" (IRC Sec. 501(c)(9). Many association programs of this type are operated on a self-insured basis with actuarially determined premiums and reserves.

THE 1982 ERISA AMENDMENTS AFFECTING "MULTIPLE EMPLOYER WELFARE ARRANGEMENTS" ARE TOO BROAD.

When it passed ERISA in 1974, Congress recognized the importance of broadly preempting state laws that would subject ERISA covered plans to varying and costly state regulations. However, late in 1982, Congress decided to limit ERISA preemption to stop an emerging abuse. Specifically, Congress amended ERISA to make it clear that state insurance laws may apply to certain "multiple employer welfare arrangements" (MEWA's), then being marketed to unrelated employers by "entrepreneurs" who frequently had no intention of providing benefits, and who were claiming to be exempt from state insurance laws as ERISA covered plans.

Unfortunately, the solution to this problem had a much broader reach than Congress contemplated, and threatens to destroy bona fide welfare benefit programs maintained by trade associations for their members. Because these programs may fall within the definition of MEWA, the preemption provisions of ERISA may not protect such self-insured programs from being classified as an "insurance company" under state insurance laws -- including hundreds of state "mandated benefit" laws. Multi-state companies and multi-employer union plans do not have this concern.

THE MEWA PROVISIONS OF ERISA SHOULD BE REFINED TO AVOID BURDENING BONA FIDE TRADE ASSOCIATION PLANS

The MEWA provisions have cast a cloud over the operations of bona fide trade association plans, and unfairly discriminate against the small employers who use these programs to provide health and other benefits to employees.

- Many association programs cover workers in a large number of states, each of which has different mandated benefit laws. Compliance with these diverse laws would prevent a uniform plan of health benefits. As a result, administrative costs may skyrocket, premiums may vary widely, and such programs may no longer be viable.

- There is no legitimate policy reason why association-sponsored programs should be precluded from operating on a self-insured basis. The funding and administration of these programs are subject to fiduciary and other ERISA standards on substantially the same basis as the self-insured plans of multi-state employers. In this regard, the policy considerations that support broad ERISA preemption apply equally to single employer plans and to multiple employer plans that cover employees of employers with a common business nexus (e.g., same industry and/or union).

- In addition to having to provide different mandated benefits, such association plans may be susceptible to varying and complex state filing requirements, premium taxes, etc., the cumulative effect of which may be to undermine their very existence.

RECOMMENDATION

Technical amendments to ERISA should exclude trade association plans from the definition of 'MEWA" (Act Sec. 3(40)). At the very minimum, benefit plans sponsored by rural telephone associations should receive the same protection of ERISA preemption as is already provided to rural electric association plans. Both associations provide valuable health coverage to thousands of employees of small employers in rural America, where the cost and availability of commercial health insurance is particularly limited.

In addition, we would like to point out the fact that the 1982 amendments to ERISA preempted or continued to preempt labor unions and rural electric cooperatives. The law states, "the provision generally exempts certain multiple employer welfare arrangements from the ERISA preemption provision". Under the provision, a multiple employer welfare arrangement is any plan or other arrangement established to offer welfare benefits, such as health insurance, to the employees of two or more employers. However, it continues preemption with respect to state law applying to any plan maintained pursuant to a collective bargaining agreement or maintained by a tax exempt rural electric cooperative.

Telephone and electric cooperatives are very similar organizations and are treated almost identically in the tax code. In this case there is no reason that telephone and electric cooperatives be treated differently. Congress, in 1982, recognized that electric cooperatives should be preempted from state law. Regretably, telephone cooperative were inadvertently not accorded the same tax treatment as electric cooperatives.

We would ask the chairman and the subcommittee members to take into consideration the hardships and logistical difficulties that our trade association faces complying with over 700 different state insurance laws. Complying with all of these different rules undermines the uniform benefit structure of the NTCA benefit plan which, in turn, enables NTCA to provide uniform explanations, claims processing and other efficiencies to our membership and helps keep benefit costs down.

Profit Sharing Council of America
Comments on
ENFORCEMENT AND ADMINISTRATION OF THE
EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

The Profit Sharing Council of America is a non-profit association that, since 1947, has represented companies that sponsor profit-sharing plans and more recently 401(k) plans. The Council represents approximately 1,200 companies who employ more than 1.75 million plan participants throughout the United States. Council members range in size from family-owned fledgling businesses to Fortune 500 size companies. All members depend upon the Council to represent and advocate their interests concerning current legislative and regulatory proposals that would affect profit-sharing plans.

PSCA members are committed to ensuring that plan participants and beneficiaries receive the benefits to which they are entitled. We believe that the vast majority of plan sponsors, administrators and fiduciaries comply with the law; too much is at stake (such as the relationship of trust with employees and the loss of tax qualification) to act otherwise. This especially is true for profit-sharing, 401(k) and other defined contribution plans where participants can and should monitor their account balances carefully.

However, serious allegations have been made about the health of the voluntary retirement system. Some experts, including leaders within the Administration, have called the voluntary retirement system the "next savings and loan crisis." The criticisms of the system seem to be aimed principally at the administration of defined benefit plans and the financial viability of the Pension Benefit Guaranty Corporation. Nevertheless, these charges have not been accompanied by evidence of pervasive non-compliance by plan sponsors, and they have led to proposals which would change the way ERISA is administered and enforced for all plans - defined contribution plans as well as defined benefit plans.

The most prominent proposals are those by the Department of Labor (DOL), which are summarized by the Department in a letter dated March 20, 1990, to Representative Tom Lantos, chairman of the House Subcommittee on Employment and Housing. Because legislative language has not been submitted to Congress as of this date, our comments will be restricted to the proposals presented in that letter.

General Comments

The rights and benefits of the participants and beneficiaries of qualified plans should be protected. Substantial powers have been given to the Department of Labor, the Internal Revenue Service, the Pension Benefit Guaranty Corporation, and the courts to ensure that these rights are protected. These agencies should continue to improve the enforcement and compliance tools in hand. For instance, PSCA strongly supports the DOL and Internal Revenue Service improvements in the Form 5500 reporting mechanism. If the information on those forms still is not adequate for enforcement purposes, perhaps more changes are warranted. Furthermore, PSCA supports and encourages increased cooperation and communication among the government agencies responsible for ERISA oversight. Improved intergovernmental cooperation and information gathering is key to identifying and eliminating fraud and abuse.

Limited Scope Audits

The DOL proposes that the limited scope audit exception in ERISA Section 103(a)(3)(C) be eliminated and replaced by a provision permitting the use of the "single audit approach." While PSCA agrees that plan assets held in trust ought to be protected, we are not convinced that the additional expense imposed by this proposal is justified. The American Institute of Certified Public Accountants estimates that eliminating the limited scope audit would increase the cost of plan audits by 10 percent to 30 percent for plans currently subject to audits. In addition, as is also proposed by the DOL, extending the requirement for this more expensive audit to small plans currently exempted from the audit requirement will greatly increase their administrative cost.

While the number of pension plans has grown dramatically since enactment of ERISA, the percentage of the private wage and salary work force with coverage has virtually remained the same for the same period of time - 45 to 46 percent, according to DOL data. At the same time, administrative costs have increased substantially due to the uncertainty and complexity of complying with the many ERISA amendments enacted by during the last few years. The objective should be to encourage businesses to establish and maintain qualified plans so that more workers are covered by retirement plans. Administrative costs are especially important considerations for instituting or sustaining profit-sharing, 401(k) and defined contribution plans, because costs may be charged against plan earnings, thus reducing the benefits of participants.

Also, requiring that a financial institution's auditor render an opinion on the financial condition of the assets in each of the hundreds or thousands of plans maintained by the institution will be extremely burdensome. PSCA believes that the financial institution's audit should focus on the adequacy of internal accounting controls on an overall basis and not on a plan-by-plan basis.

Furthermore, DOL proposes that the plan's auditor provide an unqualified opinion on the plan's financial statement. Currently, most plan auditors express no opinion with respect to assets held by a financial institution. PSCA questions whether the increased liability for public accounting firms and the concomitant increase in plan costs is justified.

ERISA Compliance Audits

DOL has indicated that it will recommend that plan auditors conduct an ERISA compliance audit in addition to the financial audit. PSCA opposes any requirement that plan auditors examine plans for compliance with laws and regulations. Financial auditors are not competent to make such legal determinations. Such audits would place auditors in adversarial relationships with their clients and would greatly increase the cost of plan administration. As stated earlier, such audit authority already rests with the IRS and DOL, and we support additional funding as needed to allow these agencies to effectively carry out that responsibility.

Private Enforcement

DOL proposes a mandatory award of attorney and expert witness fees to successful plaintiffs in fiduciary-breach actions under ERISA. The courts already have the ability to award court costs to successful plaintiffs, and PSCA supports these provisions. It is unclear why these proposals would advance efficiency or equity to those most directly affected by fraud and abuse -- the participants and beneficiaries. The objective should be to deter fraud and abuse, these proposals would only increase the threat of litigation. These proposals will only serve as a disincentive to plan formation.

Bounties

PSCA has concerns about the so-called "bounty" proposal that allows the Secretary of Labor to award a portion of the penalty under ERISA Section 502(l) to individuals providing DOL with information leading to the successful prosecution of a case. The requirement that there be successful litigation before a bounty is awarded will result in litigation in situations normally resolved outside the courtroom. Further, the use of bounties by the IRS has been of marginal value. We believe the resources of the Department of Labor could be more efficiently deployed rather than using this method to pursue groundless assertions and engage in unwarranted litigation.

Section 4975 Penalty Increase

DOL proposes to increase the penalty from 5 percent to 10 percent of the amount involved in a prohibited transaction. The purpose of any penalty increase should be to deter unacceptable behavior, not to raise revenue for the government. It is questionable whether this proposal provides any incremental deterrence.

Conclusion

The proposals submitted by the Department of Labor would impose expensive, time-consuming, and complex requirements on plans and companies. The expense incurred by all plans as a result of this shotgun approach to get at the violations of a few does not stand up to the most cursory cost-benefit analysis. Only ease of administration and less complexity will maximize the benefits received by participants and beneficiaries.

The federal agencies already have a broad mandate to enforce ERISA compliance within the framework of the provisions already in place. If the government's interest is to truly safeguard the best interests of all parties, the relevant agencies should improve their own information gathering, analysis and audit capabilities rather than thrust an additional burden on plan sponsors and administrators whose priorities are to maximize the benefits received by plan participants and beneficiaries.

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BOARD CERTIFIED
TAX ATTORNEY

FILE NO.
90,802/F

June 22, 1990

Robert J. Leonard, Esq.
Chief Counsel,
Committee on Ways and Means
U.S. House of Representatives
Room 1102
Longworth House Office Bldg.
Washington, D.C. 20515

Re: Enforcement and Administration of ERISA

Dear Mr. Leonard:

As you are aware, ERISA requires that a plan obtain a fidelity bond in the amount of ten percent of its plan assets. A recent experience of mine has indicated that the ten percent requirement is woefully inadequate to protect plan participants. I was forced to settle a case involving breaches of fiduciary duties by insolvent defendants for an amount greatly below the damages caused to the plan. Although the actions of the fiduciaries reduced the plan's assets from over 1.5 million dollars to less than $5,000, the amount of settlement recovery for the plan was significantly less. I was able to convince the insurance company to put up its entire $250,000 coverage under the fidelity bond, but was only able to obtain an additional $150,000 from the fiduciaries. Had the plan been insured by a fidelity bond in a greater amount, the recovery by the plan participants would have been significantly greater.

The cost of a fidelity bond is minimal. Accordingly, Congress should consider requiring a bond in an amount greater than ten percent of plan assets. After all, if a fiduciary is going to steal from a plan, there is no reason to think that his theft will always be limited to ten percent.

Please consider having Congress raise the percentage of assets that must be covered under a fidelity bond. Assuming that insurance companies do not raise their rates, an increase in coverage would amount to a small expense for the plan, but provide much more protection to plan participants.

Sincerely,

Bruce Spizer